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Editorial Comment

A 1944 Tax Calendar

In this issue we include (insert p. 30) a Dominion tax schedule which shows when returns and payments are due in 1944. These returns and payments accordingly include some which are on account of 1943 income and some which are on account of 1944 income. In addition the calendar includes returns and payments required in 1945 to complete settlement of 1944 taxes. Needless to say, every reasonable precaution has been taken with a view to accuracy, yet the schedule must not be considered as any more than a guide to the main requirements. There are numerous forms which are supplemental to the ones mentioned in the list, and the need for which may be encountered when the taxpayer makes out the form which is in general use. For instance, a farmer, on making out his return, finds that he has the option of filing a statement showing gross income and expenses, or of using a "Farmers T.1 Supplemental". There are several forms also which cover estates, deductions at the source, etc. In short, this calendar does not attempt to encompass the entire machinery of income and excess profits tax collection. Nevertheless it is hoped that it will be useful to the very large

number of individuals, accountants and executives who want to keep a rough check on the complicated business of tax payment.

Successive Balances In considering the form and content of financial statements, which is one of the problems currently being discussed with a view to post-war reform, attention could very well be given to the presentation of successive balances. In the earnings and profits statements which accompany published balance sheets, it is usual to find figures which are arrived at by additions or subtractions of items which are adequately described, but which themselves are not described at all. These undescribed figures are, for want of a better term, commonly referred to by accountants as "successive balances". The accountant is familiar enough with the process of calculation, but if the layman or the investor is to attach any meaning at all to such figures, then he must mentally arrive at his own description, which may or may not be right. There is even a danger that in newspaper reports and statistical analyses a wrong comparison may be made.

A speaker at the last annual meeting of the American Institute of Accountants cited extreme illustrations of such figures. A casual reference to a few published statements of Canadian corporations indicates that undescribed successive balances frequently occur. For example, Montreal Power consolidated income account contains one which is on an otherwise blank line and two others which are described merely as balances. British Columbia Power and Canada Steamship Lines each have two which are undescribed. To cite a few industrials, Canada Wire and Cable shows four, Canada Cement five, Burns and Co. four, and British Columbia Packers two.

To be more specific, a typical statement shows the following:

Sales (net)	\$11,936,481.50
Deduct—Cost of Sales	10,079,791.10
	\$ 1,856,690.40
Deduct—Selling, administrative and general expenses, including interest on bank loans and bills payable, etc.	457,624.97
	\$ 1,399,065.43

The question is, what are the third and fifth figures respectively? If they are incapable of description, then per-

VIA RAIL
VIA RAIL

haps something is lacking in our accounting technique. If on the other hand they are assumed to have an obvious place, we should be careful that the meaning is clear and identical to everyone. In these days when financial statements are interpreted or misinterpreted for every kind of purpose, the concern may be accused of having made \$1,856,690.40 profit. Nor in fact did it make \$1,399,065.43 of profit, because depreciation and numerous other items are deducted later.

By way of contrast, the statement of the Canadian National Railways has every item described. The fact that railway accounting has been forced to become definite and conclusive because of statistical and regulatory requirements of course is a contributing influence. But it does suggest that accountants have an opportunity to push the presentation of statements in general through to equally decisive form.

*Interpretation
of Statements*

Relative to the above, we may cite an illustration of the misconstrual of figures. This was brought to light some months ago by the Whig-Standard of Kingston, Ontario, in a pamphlet entitled "Facts are Important". It appears that the "United Church Observer" in its issue of June 15th, made the following statement: "In 1938, the total net income of 484 Canadian companies was 512 million dollars and in 1941 it was 930 million dollars". This remark was based on a summary put out by the Bank of Canada. But what the summary showed, in respect to the 1938 and 1941 periods, was the following:

	1938	1941
Net operating profit (before depreciation)	456	374
Depreciation, deferred development and patent write-offs	116	187
Investment and other non-operating income (net)	56	56
Bond interest (incl. exchange and amortization of discount)	76	75
Net profit before income and excess profits tax provision	320	668
Income and excess profits tax provisions	56	295
Net income to stockholders	264	373
Net income paid out in cash dividends	246	235
Undistributed income	18	138

As the Whig-Standard rightly pointed out, net operating profit is not net income, nor does the addition of net operating profit and investment income produce "net in-

come". If there is any logic whatever in the arrangement of the items, then there were no such figures as \$512 millions and \$930 millions respectively, by whatever name they might be called. Therefore to call them "net income" was doubly erroneous. And any reference to income or profits which does not include something about taxes as well as interest, depreciation and other charges, is to say the least misleading. Incidentally a new summary has just been issued by the Bank of Canada, covering a larger number of companies, and including 1942.

Of course the most complete description of each item, even to the extent of uniformity in all financial statements, would not safeguard against misrepresentation. The Bank of Canada summary actually did present a complete classification for the large number of companies covered. But the practice of "successive balances" actually invites attack, by leaving too many loop-holes.

*Government
by Formula*

At a time when the main public question is whether the state should be run for the good of the individual or the individual should be regimented for the good of the state, it is strange that we should come upon discussions which get down to such detail as algebraic formulae governing economic affairs. Of course these are to some degree interpretative—for the purpose of describing how people react under given circumstances. But in so far as they furnish suggestions as to how people should be controlled (and a great many of them are actually put forward for this purpose) they bring us to a strange impasse—either they have no relation whatever to practical affairs, or else they assume that state control is a foregone conclusion.

About two years ago there appeared under the auspices of The Dominion Bureau of Statistics a lengthy booklet which included elaborate formulae interpreting the trend of population. A few months ago a book was published entitled "Keynesian Economics" by Mabel F. Timlin which went one better than Keynes himself in developing equations to govern the human guinea pig; incidentally THE CANADIAN CHARTERED ACCOUNTANT sent a copy of this book for review purposes to a member whom it regarded as one of the brightest young men in the profession, but, not having got a word of response from him, we are forced to conclude

that he has succumbed. The topic is pertinent because we happen to have before us at this moment the November issue of "The Canadian Journal of Economics and Political Science". Being the official organ of the economically elite, this journal is entitled to be technical. But we are somewhat staggered by the inclusion in this issue of two articles which present algebraic formulae with such persistency and in such quantity that it reminds us of a mathematical text book. There is one article on "Fiscal Policy and Tariffs in Post-war International Trade" in which footnotes and formulae, with all their attendant vexities of powers and logarithms, account for about one-half the words; and another entitled "Post-war Tax Policy" which contains formulae on ten different pages, and on some of these pages the figures appear to dominate rather than illustrate the text. Without having exhaustively studied these articles, but with some knowledge of present day economic policy, we have a grave suspicion that these formulae have the ulterior motive of reducing the individual to zero and the government to infinity, and we seriously hope that they do not become the property of the National Revenue Department. And, until the basic issue is decided, of whether we will be free or subservient, we are entitled to ponder over the purpose of such exhaustive and intimate assessment of our economic potentialities.

An Income Tax Survey

By Molyneux L. Gordon, K.C.

Toronto, Ontario

(An address before a meeting of The Institute of Chartered Accountants of Ontario, November 25th, 1943.)

TAXPAYERS may be divided into two classes: First, those who pay no attention to tax; and, second, those who spend most of their time worrying about the amount they have to pay.

The first group turn their capital into income, incorporate companies in such a way as to pay a higher tax than necessary, and distribute their estates so that the government obtain an undue proportion. This group should read and study the remark of Mr. Justice Rowlatt¹ who stated: "Apparently this part of the country is inhabited by persons so unsophisticated that they enter into transactions without thinking of the income tax acts, whereas anybody who does anything ought to think, how are the income tax acts going to affect, or will they affect at all, this transaction which I am entering into?"

The second group frequently consult unqualified persons and the advice obtained is usually incorrect and expensive to follow.

Last summer I spent a few days in Haliburton and one of my neighbours there dropped in, and I asked him how he was getting on. He stated that he was making quarts of money; and then he said: "Have you heard of this here income tax? The boys were talking about it last night and I wondered if it could apply to me."

It is impossible to understand the Canadian income tax act without considering the history of the English legislation, because in many cases the language of the Canadian act is identical with that of the original English statute.

History Reviewed

Income tax was first introduced into England by Pitt in 1797 to provide funds to defeat Bonaparte. The act was amended in 1803 and again in 1806 and was dropped after the battle of Waterloo. It was re-introduced in 1842 and in 1853 Mr. Gladstone proposed to abolish the tax because he confessed himself unequal to the equitable enforcement thereof.

Prior to the great war income tax was levied to a very modified extent in some of the dominions. For instance, in most parts of Canada there was a municipal income tax. In Australia there was a state tax. Shortly after the commencement of the last war it became necessary to raise large sums for defence, and the various dominions, big and little, imposed an income tax. In Australia the act was passed in 1915; in Canada, 1917; in India, 1922; and in South Africa, 1925. All these acts sprang from the same root and are largely based on the English legislation which, in turn, retains most of the features and in some cases the precise language which appeared in the early English acts of 1797 and 1806.

It is estimated that in 1797 only 25% of the inhabitants of England could read. There is no estimate of the number of persons who could write, which is a horse of an entirely different colour; and the number of people who could keep books must have been very small. There is still in existence a directory of the City of London, England, dated 1799, which lists eleven persons as accountants—and at that time the word accountant was usually employed to describe a bookkeeper and not a man who audited accounts for others.

The original act was passed 28 years before the first steam engine, the Rocket, made its trial trip, and, as you know, a horse preceded the engine and, to the great amazement of the onlookers, had to get off the tracks to avoid being run down. The idea that machinery made of iron could wear out did not occur to anyone. The taxpayer, however, knew all about horses, and in 1853 the act was amended² to permit the deduction of keeping a horse; but it was not until 1878 that anyone thought a deduction should be allowed³ for the diminished value by reason of wear and tear of machinery during the year, in other words, depreciation. No one thought that the crude machinery which did exist could ever be improved. Shortly before the battle of Waterloo the Duke of Wellington is reported to have said that he did not want any new-fangled weapons. The British musket was the best weapon ever invented and if the British treasury would give him a sufficient number of muskets he could recruit men to pull the triggers and was confident of beating the French. Consequently, there was no provision in the early acts covering obsolescence. The first mention of obsolescence appeared in the English

statutes in 1926; but in Canada we are still further behind. The Canadian statute does not mention the subject at all except with reference to munition plants.

Bad Debts

In the early days most people who kept books kept them on a cash basis. That is to say, they put on one side the cash they received and entered expenses on the other, and the difference was their taxable profit. Consequently, no provision was made in the 1797 Act to cover bad debts; but a section was inserted in 1806 which reads as follows: "No sums shall be deducted from any debts except such debts or such parts thereof as shall be proved to the satisfaction of the commissioners to be irrecoverable and separate." This section is very similar to section 6 (d) of the Canadian statute which reads as follows:—"A deduction shall not be allowed in respect of . . . (d) . . . except such an amount for bad debts as the Minister may allow."

Questions in regard to allowances for bad debts have been before the courts nearly one hundred times, and some of them are very important. The Canadian practice is to permit a creditor to write off a debt when it becomes bad, but if he subsequently collects the debt he is required to include it in the profits of the year in which the money is received. As his taxes have steadily increased, this may mean that he has to pay a great deal more than if the debt had been paid on time. The Privy Council held^a in a case from Jamaica that if a debt was once written off as bad no tax could be charged if it was collected in a subsequent year, any practice of the Inland Revenue to the contrary notwithstanding. Although I am not prepared to say that this case governs the Canadian practice, because it was decided on a different statute, I am inclined to think that tax should not be collected at a higher rate than the one in force when the debt was incurred.

The act is now applied to situations which were not even thought of when it was originally introduced. In 1797 insurance was in its infancy; very few companies were in existence; and bond issues and reorganizations practically unknown.

Ambiguous Words

Each time you refer to the Canadian statute remember that standing behind you is the ghost of the man who

drafted the legislation of 1797, a man who specialized in the use of words of more than one meaning and arranged these words in sentences of the greatest ambiguity. No statute has been subject to so much judicial criticism. I would refer to the judgment of Lord Wrenbury⁵ who stated as follows:—

If it were competent to a court of law to censure the legislature, or if any useful purpose could be served by censuring the legislatures of 1842 and 1853, no censure could be too strong, I think, for having expressed an Act, and that a taxing Act, in language so involved, so slovenly, and so unintelligible as is the language of the acts of 1842 and 1853 . . . As a member of the joint committee of both houses to which was referred the consolidation bill which is now the Income Tax Act, 1918, I strove to find some way in which we could deal with the language of confusion and unintelligibility of the acts to be consolidated. . . . If parliament had the time, which it has not, the law of income tax, which now so vitally affects the subjects of the realm, ought as speedily as possible to be expressed in a new statute which should bear and express an intelligible meaning.

and the judgment of Lord Sumner,⁶ who states:

It is a most wholesome rule that in taxing the subject the crown must show that clear power to tax was given by the legislature. Applied to income tax, however, this is an ironical proposition. Most of the operative clauses are unintelligible to those who have to pay the tax, and in any case derive such clarity as they possess from the judges who have interpreted them.

Lord Macmillan has stated:⁷

In many instances the courts have had to resort to artificial interpretations in order to make the acts work.

This means that if the statute describes a thing as white, the courts may come to the conclusion that parliament intended to use the word red, or, possibly, black.

As an example of this sort of thing, I refer to section 66 of the English act of 1806. This section imposed a tax upon "all profits arising from annuities". The definition of "income" in the Canadian act reads as follows: "Annuities or other annual payments received under the provisions of any contract." The Courts have held that the words "annual payments":

- (1) include weekly payments;⁸
 - (2) include any payment made in any year;⁹
 - (3) do not include debts paid by annual instalments;¹⁰
 - (4) that if an instalment of capital includes interest¹¹
- the payment must be analyzed and the interest taxed.

Meaningless Terms

Other sections of the act have practically no meaning. Take clause 6 (a) which forbids the deduction of disburse-

ments or expenses not "wholly, exclusively and necessarily laid out for the purpose of earning the income". If you applied these words literally practically every expense would be prohibited. Let us first deal with the word "exclusively". You might occasionally use the telephone on your desk to telephone your wife that you won't be home for dinner. Apparently such use would prohibit the deduction of the whole expense. Your stenographer might write a personal letter, and the same rule would apply. Then consider the word "necessarily" and what would happen if this word were given its ordinary meaning. The tax inspector might come into your office and claim that a new typewriter was not necessary and you could get along with the old. No one should get the idea that these words are dead letter. They are perhaps the most important and most objectionable words in the act. In 1942 the Supreme Court of Canada disallowed the deduction of \$2,282,679.42 which had been expended by the Montreal Light, Heat and Power Consolidated in refunding the bonds issued by the company, at a lower rate. Judgment proceeded on the ground that the money was not expended for the purpose of earning the income.

Interpretations

This brings us to the point where it is necessary to consider the best method of interpreting the act. It was stated¹² by the Barons of the Exchequer Court in 1540 (which was the second year of the reign of Queen Elizabeth) that:—" . . . the sages of the law heretofore have construed statutes quite contrary to the letter in some appearance; and those statutes which comprehend all things in the letter they have expounded to extend but to some things; and those which generally prohibit all people from doing such an act, they have interpreted to permit some people to do it; and those which include every person in the letter, they have adjudged to reach to some persons only; which expositions have always been founded upon the intent of the Legislature, . . ." This does not help very much in dealing with the Income War Tax Act, because you all know that it takes a great deal of time and study to understand the act and it is quite impossible that any member of parliament who is not an experienced accountant or lawyer could realize the effect of any section which

was brought before the house. In a recent case Sir Lyman Duff, Chief Justice of Canada, stated that he would admit that parliament had read and passed a certain section but he was not prepared to concede that they had either considered the same or understood the meaning.

To illustrate this principle, I refer to a case in which a member of your profession, Maurice Samson, was the victim—or perhaps I should more correctly say, the victor. Mr. Samson was appointed leather controller at a salary of \$1. per annum plus a living allowance of \$20. per day while absent from his place of residence in connection with the duties aforesaid. The Court held ¹³ that this living allowance was not part of Mr. Samson's income notwithstanding the fact that section 3 (e) states that income shall include personal living expenses.

It has been frequently stated that the modern financial statement does not correctly show the amount of profits subject to tax.¹⁴ This is due to the fact that in the last 100 years your profession has made great strides but the principles to be applied in calculating taxable income are in a general way set out in the act of 1806 and these principles, with few exceptions, have been introduced into the Canadian statute.

In order to prepare a proper tax statement you must forget a great deal that you have learned and adopt opinions and methods which were in force 150 years ago and then ascertain how far these opinions and methods have been modified by cases which have been decided since the act was introduced.

A Source of Litigation

The British Empire has produced 68 volumes of income tax reports containing 50,000 pages, and there are probably more than 2,500 decisions applicable to Canada; many of them interpret sections containing the precise language which appears in the Canadian act. Decisions from other parts of the empire are particularly interesting because you can obtain complete coverage of certain branches of business which are not common in Canada. For instance, money-lending is a major industry in India and almost every question in regard to bad debts has been decided by the Indian courts and quite a percentage have reached the Privy Council. South Africa is rich in minerals and

many questions on the taxation of mining profits, the promotion and organization of companies, and the buying and selling of options, have been thoroughly discussed.

The Canadian act has been considered by the Canadian courts on 70 occasions. The Department have been successful in 45 cases, have lost 20, and in 5 cases the honours were divided. I think it is fair to say that with a slight modification of plan, one-third of the cases won by the Crown would have been decided in favour of the taxpayer, and in some instances the taxpayer's position would have been so clear that there would have been no litigation.

The main purpose in studying the authorities is to obtain a dictionary, because if it has been decided that a certain expression of the act means one thing while the ordinary meaning is apparently another thing, you will be misled if you trust to the ordinary meaning.

Special Cases

Next it is necessary to learn the rules. Let us assume that there are 2,500 cases which are applicable to Canadian conditions and approximately one-third of these were decided in favour of the taxpayer, this means there are 800 rules which might assist your clients. But do not overlook the 1,700 cases which were decided in favour of the Crown! They are far more important because a study of these cases will enable you to advise your clients to refrain from entering into transactions which might prove expensive. Many striking examples could be given, but I would just refer to the mining company which constructed a siding in 1931 and arranged that the railway company who used the siding should give them a rebate of 10% on the freight until the cost of the siding had been repaid. The Court held¹⁵ that the rebate was taxable. Eight years later another company who required a siding did precisely the same thing, but they agreed that as soon as the rebates covered the expense of construction they would transfer this siding to the railway company, and it was there held¹⁶ that the rebates were nothing more than instalments of purchase price and, consequently, non-assessable.

The cases deal with many situations which are not mentioned in the act, and in such cases your client's rights entirely depend upon the view taken by the courts. It is law that a taxpayer is entitled to value his stock-in-trade

at cost or market. Nothing appears in the act as to what should be done with raw material which is on order but which has not been delivered in cases where the market has dropped. I do not know why the courts decided¹⁷ that a loss which might be incurred in connection with such orders might not be deducted from the taxpayer's profits, but I would point out that if the taxpayer had been aware of this decision he could have saved himself the extra tax by obtaining delivery of the goods before the end of his financial year.

Liability to tax frequently depends upon the form of the transaction, and if you do a thing in one way you will be liable to tax, but if you do it in a different way you will be tax free. A farmer has a gravel pit. He digs the gravel and delivers it to customers. He will be taxed on his profits just the same as anyone else who operates a mine. He authorizes a contractor to go and get the gravel and receives so much a yard, and under section 3 (g) the farmer pays tax on the royalties. If he sells the contractor a definite quantity he may be free because the Privy Council have held¹⁸ that the word "royalty" signifies that portion of the *reddendum* which is variable and depends upon the quantity of minerals gotten, so that if a definite quantity is sold there may be no tax to pay. On the other hand, if the farmer calculates that his ground contains 10,000 yards of gravel per acre and sells the land, unquestionably he will be tax free.

The legal and accounting professions are in no way com-

REFERENCES

- ¹*Seaham Harbour v. Crook*, 16 T.C. 333.
- ²16 & 17 Vic. chap. 34, s. 51.
- ³41 Vic. chap. 15, s. 12.
- ⁴*Gleaner Co. v. Assessment Committee*, [1922] 2 A.C. 169.
- ⁵*Great Western v. Bater*, [1921] 2 A.C. 1.
- ⁶*National Provident v. Brown*, [1921] 2 A.C. 222.
- ⁷Report of the Income Tax Codification Committee, 1936.
- ⁸*In re Janes Settlement*, [1918] 2 chap. 54.
- ⁹*Martin v. Lowry*, [1927] A.C. 312.
- ¹⁰*Scoble v. Secretary of State for India*, [1903] A.C. 299.
- ¹¹*Beck v. Howard de Walden*, 23 T.C. 384.
- ¹²*Stradling v. Morgan*, 1 Plow. 205, a.
- ¹³Minister of National Revenue v. Samson, [1943] Ex. C.R. 17.
- ¹⁴*Gresham Life v. Styles* (1890), 25 Q.B.D. 60.
- ¹⁵*Westcombe v. Hadnock Quarries*, 16 T.C. 137.
- ¹⁶*Legge v. Flettons, Ltd.*, 22 T.C. 455.
- ¹⁷*Collins v. Commissioners of Inland Revenue*, 13 T.C. 773.
- ¹⁸*Attorney-General v. Mercer*, 8 A.C. 774.

petitive but are entirely complementary. Our highest aim is to serve our clients efficiently. This is an age of specialization and in order to be of service to the public it is necessary to have a thorough knowledge of the work we undertake. I am much opposed to a suggestion that has been made that lectures in accountancy should be given to our students so that they may be qualified to prepare income tax returns; and I think it would be just as unfortunate if the members of your profession commenced to study law. No lawyer should take up tax matters without having the figures prepared by a competent accountant; and I think that when legal questions arise members of your profession would find it of advantage to discuss such matters with some member of my profession. I strongly recommend that the governing bodies of both professions should get together and indicate the proper sphere of each.

Tax Questions and Answers

(Following the address of Molyneux L. Gordon, K.C. (which is published in this issue) at the meeting of The Institute of Chartered Accountants of Ontario in November, there was a discussion period in which specific questions were answered by the speaker. The questions and answers are reproduced herewith.)

Lump Sum Payments to Employees

QUESTION—It is fairly well established in law that lump sum payments to employees under contract made upon termination of employment constitute capital receipts in the hands of the employees and are not taxable income.

Are there any conditions under which these might be treated as deductible expense when computing the taxable income of the companies which have made the payments?

ANSWER—Liability to tax depends upon the facts of each case.

(a) If a taxpayer purchases a company and agrees to compensate the executives, the sum payable is considered part of the purchase price¹;

(b) If a taxpayer controls a privately owned company and is given a bonus on retirement, this would be considered a distribution of profits²;

(c) Damages for wrongful dismissal may be deducted by the payor³ and are non-assessable in the hands of the payee⁴;

(d) Under s. 5 (m) if you make a special payment to augment a pension fund you may deduct 10% each year for 10 years. If the employee receives a lump sum, one-third is taxable under section 3 (c) ;

There are exceptions to the general rule in each case:

(e) If a man is engaged for a year and dismissed at the end of 6 months and receives his salary in a lump sum for the balance of the year, the amount is considered as salary and is taxable as such⁵;

(f) If a taxpayer controls a private company and this company agrees to pay pensions and fails to do so and the amount is furnished by the controlling shareholder, the amount is not deductible because the obligation is that of the company and not of the shareholder⁶;

(g) Employees are not taxable on amounts received as consideration for undertaking not to compete⁷;

(h) If the court comes to the conclusion that a payment is a personal gift the recipient is tax free⁸;

(i) Payments to employees after the close of business are non-deductible because they are not paid for the purpose of earning the income⁹.

REFERENCES

¹Royal Insurance v. Watson (1897), A.C. 1.

²Overy v. Ashford Dunn, 17 T.C. 497.

³Mitchell v. Noble (1921), 1 K.B. 719.

⁴Ducros v. Ryall, 19 T.C. 44.

⁵Income Tax Case No. 63, 2 S.A.T.C. 253.

⁶Johnston v. Commissioner of Income Tax, 7 I.T.C. 350.

⁷Beak v. Robson (1942), T.R. 349.

⁸Mulvey v. Coffey (1942), T.R. 277.

⁹Commissioners v. Bell, 12 T.C. 1181.

Refunds

QUESTION—Section 56 of the Income War Tax Act provides that the Minister may at or prior to the issue of the notice of assessment or on the application of the taxpayer within twelve months after the issue of the notice of assessment or the payment of the tax, refund any overpayment made by the taxpayer.

What is the effect of this section with respect to assessments which have been issued not more than twelve months previously? Does it merely permit the Minister to make a refund when the tax paid exceeds the tax shown to be due on the assessment, or does it convey any right to the tax-

payer to have an assessment reconsidered and any resulting overpayment refunded?

If the first of these interpretations is the correct one, then what is the effect of Section 53 which directs the Minister to refund an overpayment?

ANSWER—I think it is clear that the Crown is not bound by returns made by the taxpayer (*Birtwistle Trust v. Minister of National Revenue* (1939) S.C.R. 125); and that if a taxpayer can show there is an error in the returns he has the right either to have the returns amended or to file new returns.

I think everybody will concede that the Department treat all taxpayers alike and with absolute fairness. An official may take a different view of the law from the one taken by the taxpayer and the taxpayer may feel the view is incorrect, but if he can satisfy the Department that he is entitled to a refund I do not think he will have any trouble obtaining the same.

Expense Allowances

QUESTION—Mr. Justice Thorson in giving his judgment of February 27, 1943, on the appeal of Maurice Samson against an assessment of income tax on living allowance made the following statements:

"It may well be that sums of money received by a taxpayer as wages or salary, even although they are of a fixed amount, may be subject to deductions other than those specifically permitted, such as charitable donations and the like, in order to determine the amount that is properly assessable for income tax purposes under the provisions of the Income War Tax Act.

"Furthermore, the statement that an annual salary, being an amount duly ascertained and capable of computation is 'of itself' a 'net' income, and taxable as such under the statute, is, in my opinion, at variance with the definition of 'income' contained in the taxing statute itself."

Would this be sufficient authority for a taxpayer who received a salary under an employment contract which required him to provide and use a motor car in the performance of his duties at his own expense to establish the right to deduct the motor car expenses incurred in the performance of his duties from his salary income?

ANSWER—The decision in the *Lieutenant-Governors'*

case is in accordance with the law; but it is doubtful whether the statement by Mr. Justice Audette that salary is of itself a net income can be considered as correct in view of the later judgment by the Hon. Mr. Justice Thorson.

In most cases the employee is in the hands of the Department because, strictly speaking, he can only deduct the expenses of the car if it is used solely and exclusively for business purposes, and it might be most difficult for anyone to prove that the car had never been used for personal purposes. This is another case where liability depends upon the form of the transaction, because, if instead of giving the employee a fixed salary and expecting him to personally pay the cost of the car, the salary was reduced and the car provided by the employer, no controversy could arise.

Appeal Under Excess Profits Tax

QUESTION—Section 5 (4) of The Excess Profits Tax Act provides that when a decision of the Board of Referees is approved by the Minister, the decision is final and conclusive. Is the taxpayer thus precluded from appealing the decision to the Exchequer Court? Has the taxpayer as well as the Minister the right of reference to the Treasury Board?

ANSWER—The taxpayer has no right of appeal under the Act.

Undistributed Income

QUESTION—What does "undistributed income" mean as used in Section 19 (1) of the Income War Tax Act?

Does it include capital profits such as arising from sale of capital assets or from life insurance?

ANSWER—Undistributed income on hand does not include capital profits or money arising from life insurance. It does include moneys arising for use and occupancy insurance, and also the proceeds of insurance against loss of profits while plant is idle due to fire damage. (*The King v. B.C. Fir & Cedar Co. (1932), A.C. 441*).

It may be doubtful whether the expression would include fixed assets built out of earnings.

Definition of Income

QUESTION—The New Zealand Court of Appeal has held that if a company continues to pay a salary to an

employee who has enlisted in the army, such payments are gifts and should not be included as part of the taxable income of such employee.

In the past such payments have been considered in Canada as income and treated as an allowable expense in so far as the corporation employing such persons is concerned.

Is the decision of the New Zealand Court of Appeal sufficient authority to appeal against taxation in Canada of such income in the hands of the enlisted employee? If so, would the payments by the employer be permitted as deductions from the employer's income?

ANSWER—Under section 3 income is defined amongst other things as being wages, salary or other fixed amount.

Wages are paid for doing work and payment to an employee who has enlisted is clearly paid because he is working for the King and not for the company, and, consequently, are not taxable.¹

The specific point came up in New Zealand and it is probable that this judgment would be followed in Canada.

There are three limits to the principle:

(1) It might not apply to director's fees because a director could give advice notwithstanding that he is fighting in Italy.

(2) It might not apply to relatives of the owners of a business if other employees were not included.

(3) It might not apply if in consideration of such payment the employee agreed to return at the conclusion of peace.

It does not apply to a partner who continues to draw his share of the profits.

In reply to the second question, it is well settled that pensions are deductible expense because they encourage other employees to work². If some employees enlist and others remain I know of nothing that would encourage those who remain to chip in and do extra work than the knowledge that those who had left had received generous treatment.

For these reasons I think the payments made by the employer are proper deductions.

During the last war the specific question came up in an inferior court in New South Wales and the deduction was allowed³.

REFERENCES

- ¹Fullerton v. Minister of National Revenue (1939), Ex. C.R. 13.
²Smith v. Incorporated Council of Law Reporting for England and Wales (1914), 3 K.B. 674.
³Arnott v. Commissioners of Taxation, R. & McG. Ct. of Rev. (N.S.W.) 63.

Consolidated Returns

QUESTION—Where a holding company has been filing a consolidated return for say six companies and it acquired a seventh subsidiary, can the holding company elect whether or not to include the seventh company in the consolidated return for income tax purposes?

ANSWER—I think it would be wise to obtain a ruling on this question from the Department of National Revenue. Eliminating unnecessary words, section 35 (3) reads as follows: "... The owning or controlling company may, in respect of all such companies which carry on business in Canada, elect, before the commencement of the earliest fiscal period of any of the constituent companies in respect of which consolidation is desired ... file a return in which its profit or loss is consolidated with that of all of its subsidiary companies carrying on business in Canada ... " and if this section is strictly interpreted the consolidated return must cover all subsidiary companies.

Refundable Tax

QUESTION—Under what section of the act is a company prohibited from assigning the refundable portion of excess profits tax?

In the case of a company winding up what becomes of the refundable portion of the excess profits tax?

ANSWER—The Excess Profits Tax Act does not prevent a company from assigning the returnable portion; but there is some doubt as to whether such a claim is assignable by law. If a company becomes bankrupt the returnable portion of the tax becomes vested in the trustee in bankruptcy, but if the company's charter is surrendered it escheats to the Crown.

A Question on Occupation

QUESTION—A taxpayer's chief occupation is that of a speculative builder. In the course of his activities he acquired a number of rented properties. He ceases his building operations and for a number of years sells no properties.

During this period his only income is the rents received from his rented properties.

Having regard to the fact that this taxpayer would be taxed on any profit arising from the sale of his rented properties, would such rent income be investment income subject to surtax? Could such rent income be both subject to investment income surtax and excess profits tax in a year in which profits on sale of properties were sufficient to bring this taxpayer under The Excess Profits Tax Act?

ANSWER—One of the strongest principles of income tax legislation is that each year must be treated separately; and if this taxpayer had ceased his building operations and had sold no properties for a number of years, the rents he received from his houses would be investment income.

The latest decision on the subject was given by the Court of Appeal in England in February of this year (*F. P. H. Finance Trust v. Inland Revenue Commissioners*, (1943) 1 K.B. 345). In that case a company had carried on business for a number of years and had lost a great deal of money. For 15 months preceding the assessment the company had not carried on business but only received moneys from investments. The court held they could not look at the previous history and must deal with conditions as they existed during the current year.

Standard Profits

QUESTION—A limited company incorporated in October, 1941, made less than \$5,000 net profit from its operations to December 31, 1942, and filed Form T.2—1942 without giving any reference to standard profits.

It is expected that the company will make substantial profits in the calendar year 1943 or perhaps not until the calendar year 1944. When should application be made for the determination of standard profits, and on what basis will such determination be made by the tax department?

ANSWER—I think it would be advisable to take this question up with the Department of National Revenue.

If the company is not within the 100% class, there seems no reason to ask the Board to fix the standard profits.

If the company was incorporated after 2 January 1939, the Minister is obliged to refer the question to the Board, and until he does so the taxpayer may not be under any obligation to make an application.

The Board will determine the standard profits at such an amount as the Board thinks just being an amount equal to a return on the capital employed by the taxpayer at the commencement of the first year or fiscal period in respect of which he is subject to taxation under the Act at the rate earned by taxpayers during the standard period in similar circumstances engaged in the same or an analogous class of business.

Total Profits

QUESTION—In sub-section (a) of Section 6 of The Excess Profits Tax Act would the term "total profits" mean profits as defined in Section 2 (f) *plus* inventory reserve "added to the taxpayer's profits" pursuant to the provisions of Section 6 (b) ?

ANSWER—Yes.

Ethics and Relations Between the Accountant and His Client

By George C. McDonald

Chartered Accountant

Montreal, P.Q.

(One of a series of staff talks. Others will be printed later.)

ETHICS are the rules of conduct which govern men in their relations with each other. As civilization progressed, people with common interests joined together in groups to pursue a common end. Thus developed trades and professions. As the members of various groups gathered experience, they came to recognize certain practices which tended to promote the best interests of the group. Once recognized as such, these practices became the established rules of conduct and, ultimately, the code of ethics of the trade or profession. Once such rules are established, it is not easy to change them, even after they may have outlived their usefulness due to altered circumstances.

Our profession, however, coming as it did so much later than others, had the benefit of the growth and experience of older professions like law and medicine. In other words, we had the opportunity of realizing from the experience of others that the higher the standards, the greater the

achievement. Both law and medicine have achieved high standards of ethics.

A Public Responsibility

At this stage I want to say a word or two about the ethics of the profession as applied to the individual. I would refer you to certain chapters in a little book by A. P. Richardson entitled "The Ethics of a Profession". In chapter 6 there are references to what a lawyer and a clergyman can do through living in a community and having an effect on the whole tone of the life of the people. In a similar manner, the accountant can play a very important part. Take the matter of the protection of the interests of employer and employee. He can act as an arbitrator and holder of the balance between capital and labour. He should be a very able critic of governmental finances. I would lay special emphasis on the part that professional men can play in public affairs in counteracting the influences of self-seekers and pressure groups. I quote the following from the chapter on "The Accountant's Place in the Community":

"Everyone knows that many of the people who desire office are in that most contemptible of classes, the office seekers. They are politicians pure and simple, although perhaps neither pure nor simple. From year to year they live in the hope of higher appointment with more emolument and greater graft, and most of the people are content to let this sort of leech suck the blood of the community. Some of these politicians think that they are honest, but as a rule it is quite safe to say that the man who lives only by the suffrage and sufferance of the voters is not of much benefit to the town or state or nation."

A Rise In Status

In this country, accountants as yet have not played much part in public affairs, but they are beginning. The part that they are playing, both in actual participation in the war and helping with governmental problems, augurs well for the future. I think the following two paragraphs from Richardson's book are prophetic as contrasting the old-fashioned, narrow point of view which accountants were supposed to hold with what is actually taking place:

"Now the accountant worthy of the name is a different fellow altogether. The windows of his office are clean and

open. The light shines in and he nods to the people passing by. When anything of importance is toward, he rushes out and joins the throng to see what he can do to help. People like him and they say, 'Here is a good citizen who knows his work and is ready to help the rest of us with his knowledge'. He becomes a power in the community and is loved and esteemed by every reputable citizen. The crooks and grafters hate him, but they dare not despise him. He does good work, raises the level of living, and at the end of the day, he goes to rest honoured by all.

"There are such men and as time goes on there will be more and more of them. The little myopic wretch with bent shoulders and grasping hands is going out of fashion. Vision, energy, accomplishment and the good of the community are uppermost in the minds of the men who are to amount to anything in the profession. There have always been some of these big men and so the profession has lived in spite of the other kind, but it seems now that the relative proportion is changing and the exception is now the small fellow. And this all means that if accountancy is not to be destroyed by accountants and if the profession is to advance to its proper position, every accountant must be ready to devote his talents and his time, so far as possible, to the affairs of the town, the state and the nation."

The Problem of Secrecy

I next want to refer to chapter 14 on "Secrecy". The private affairs of the client must be sacred, and no fact should be more strictly impressed on the junior members of the profession than this one. Another angle develops, however, when the accountant finds his client breaking the ethical code. I quote the following paragraphs:

"As an illustration of this, let it be supposed that an accountant preparing the income tax returns of a client, finds that the client has been guilty of fraud for the purpose of evading legitimate taxation. The accountant is engaged by the client in a privileged and confidential capacity; the accountant is a member of a profession whose conception is truth; the accountant is a member of the community and has, like everyone else, a duty to the government. What is his obligation in such a case? If he withdraws, as he will naturally be inclined to do, is he not tacitly permitting a felony to proceed? If he reports the

matter to the government, is he not guilty of a breach of confidence?

"This is a difficult problem and there is a wide difference of opinion as to what should be done. It seems to be the predominant belief, however, that the accountant should regard himself first as a servant of the public and secondly as a servant of the client. If that be so, it is his duty to prevent fraud by any legitimate means in his power."

The Client's Obligations

In our daily practice, we continually have occasion to remind our clients of their obligations to the state. This situation is being helped by the impact of the war, which has cast a clearer light on our duties and obligations, but there are quite a lot of bad traditions to break down. Some of the so-called leaders of the people who have special axes to grind, are responsible for misleading people from the straight and narrow path. We often hear it said that it is all right for the small fellow to cheat the government, because the big fellow can hire able lawyers and accountants to protect him from the exactions of the income tax department. Therefore, the small fellow is entitled to take care of himself. If he believes that everybody else is getting away with murder, it is pretty difficult for the small fellow not to want to get on the band-waggon. I believe that at the present state of our civilization, we have quite a good code of ethics, and that the average individual is fundamentally decent, honest and anxious to play his proper part in society. Unfortunately, we must admit that there are still some dishonest people who cheat, and do not take their share of the social burden. They are not confined to any one class, they appear in all walks of life—wherever human beings are, there are some with lower moral codes than others. We can only hope that with better education and a higher sense of social obligation, moral codes will go on improving.

Professional Qualifications in General

To conclude my reference to Richardson's book, I quote from chapter 20 as follows:

"It is a tradition of the professions that all who practise them must be gentlemen or ladies. They must be people of education, refinement and that delicate, indescribable knowledge of what is proper which is called tact. They

must be people to whom right is as natural as breathing. And above all, they must be strong, steadfast, sure. Some are born with these qualities and many others acquire them. The man or woman who is to occupy a position in a learned profession must know the correct thing to do in all circumstances, and much of that knowledge must be instinctive. In the practice of a profession there will arise innumerable problems which will call for the nicest solution. Without a sense of the proprieties, the practitioner will be fatally handicapped.

"It is not wise to labour under the belief that, while ethics may be well enough, the great factor is monetary success. A few people may succeed without observing the principles of right conduct, but the majority of those who will attain success will do so by following the road of good custom."

And finally,

"After all the argument and disputation, after all the theory and doctrine, after all the study and analysis, the conclusion of the whole matter is this, that a professional man does not live unto himself alone and what he does carries an influence far and wide. Every unworthy deed is a power for evil. Every good deed helps the world."

I want to make two references to the proceedings of the American Institute of Public Accountants:

1. 1940 Report, Edward B. Wilcox on "Professional Ethics": "The accountant has a contractual relationship with his client who, he knows, may cease to employ him, but he must nevertheless deny the wishes of his client if they conflict with his moral duty to the public, even though that public has little opportunity either to thank or blame him. I know of no higher ethical requirement than this, and yet it is one which accountants have voluntarily imposed on themselves."

2. 1941 Journal of Accountancy—F. H. Hurdman on "Ethics of the Accounting Profession": "Accounting, like law, medicine and engineering, is a service in which the public has a peculiar need of protection against lack of skill and lack of integrity. The public needs protection because it cannot itself judge the quality of technical work."

Specific Requirements

To come to the other part of my subject, I want to set out briefly what governs our relations with our clients:—

1. The Society's rules of professional conduct and the traditions of the profession.

2. Certain acts granting corporate powers to our clients—The Bank Act, the companies' acts (Dominion and provincial), special charters for particular corporate bodies.

3. A lot of other laws, including the civil code, income and war profits tax acts, sales tax acts and a host of others.

In so far as they have a bearing on the statements which we certify, we must see that the requirements of these various regulatory instruments are being complied with. It is not sufficient, however, to be satisfied to rest within the bounds of the various legal requirements. We must see that the statements we certify and the reports we make satisfy the standards which have come to be recognized by the profession.

I think that the introduction of the T.2 Questionnaire has been most stimulating to the profession. It has forced us to clarify our minds and place emphasis in our reports on the things that we have done, rather than the negative approach of stating the things that we have not done. We must take a firm attitude in the matter of qualifications such as "subject to the adequacy of the reserve", and other ambiguous terms.

In the past there was a tendency, in fact a general practice, to use such terms as "complete audit", "detailed audit", and "balance sheet audit". The T.2 Questionnaire is changing that. Already we had been using the word "examined" instead of "audited", and I doubt if the words "complete audit" will again be used.

In dealing with clients, we must keep in mind that very few understand the difference between these various kinds of audits, and unless the client has as controller a chartered accountant, we must make our reports in language from which the uninitiated will understand the scope of our examination and the extent of the responsibility assumed in our certificate.

Types of Clients

A word or two about the problems that are likely to crop up in relations with clients. The client appears in many different forms. For corporations we have—

1. Abstract form of the company itself.
2. Shareholders, and sometimes a shareholder.

3. Directors, and sometimes a director.

4. The manager and other officers.

For private business, partnerships, etc., we have—

1. The owner.

2. The partners, and sometimes a partner.

In all cases, there is some one or more persons in charge of the books and accounts—the secretary, treasurer, controller, accountant or bookkeeper. Our attitude and course of action is dependent on the nature of our instructions and the purpose of the audit, examination, investigation or whatever we are required to do. Most of our inquiries and discussions will naturally be with the accountant and his subordinates, up to the stage when it becomes necessary to go higher up, to the manager, and perhaps the president. In the normal course of an audit for shareholders, it should not be necessary to go further, but in some cases, we may feel called upon to seek an interview with the board of directors, and even on occasion address the shareholders at their annual meeting, which auditors under the Dominion Companies' Act now have the right to attend. In all cases, and at all stages, we must be careful to limit our comments to what is appropriate to discuss with the particular individual or group. The kind of problems we are apt to run into go from one extreme to another. In some cases we have what I hope may be referred to as the old-fashioned president who wants to "treat 'em rough and tell 'em as little as possible". In other cases, we meet enlightened people who believe in putting the fullest possible information in their statements, and who take pains to see that the position of the company is explained to the employees as well as to the shareholders.

Information in Statements

Many arguments arise over the form of the statement and the amount of information, and it will generally be found that the person arguing has some special purpose to serve, for example:

1. To create a certain impression on the bank.

2. To give the least possible information to the income tax authorities.

3. To give the shareholders an unduly favourable impression of the amount of capital in the business.

4. To give less information in the revenue and expendi-

ture or profit and loss account than is generally considered good practice.

These are only samples. You will meet all kinds of arguments, including "such and such a company does it this way, why can't we do it this way?" When it is a matter of principle, we must be firm.

There is another phase of our relations with our clients on which I want to say a word or two. The increasing complexity of taxation and accounting problems is bringing out the absolute necessity and great benefit to be derived from consultation. The T2 Questionnaire is the result of consultations between a committee of The Dominion Association of Chartered Accountants and officials of the Income Tax Department. In our daily work we find ourselves more and more seeking consultations with our partners, other accountants, lawyers, bankers, government officials and others seeking to find solutions to the ever increasing and complex problems of our clients. In conclusion, I wish to commend the value of more conferences on professional matters to our provincial societies, as well as to The Dominion Association of Chartered Accountants.

Canada's Exchange Relations with the Sterling Area

(A number of our members have stated that they do not fully understand the reasons for the activity of the Foreign Exchange Control Board in requesting Canadian subsidiaries or branches of sterling area companies to transfer to their parent companies payment for current earnings. After consultation with officers of the Board, the following notes of explanation have been assembled.)

ON March 18, 1942, Honourable J. L. Ilsley, Minister of Finance, introduced to the House of Commons a resolution providing for the raising and expenditure of a sum not exceeding one billion dollars for the purpose of enabling the United Kingdom "to purchase in Canada aircraft, tanks, mechanical transport vehicles, guns, ammunition and other munitions of war, foodstuffs, raw materials and any other commodities and supplies essential to the conduct of the war and the maintenance of the people of the United Kingdom, and to assist in enabling the government of the United Kingdom to defray other expendi-

tures incurred in Canada for war purposes". In a lengthy statement on the resolution he brought out the fact that British requirements of Canadian dollars to make payment for their large purchases have greatly exceeded the amount of Canadian dollars they have realized through their exports to Canada, through their receipts of interest and dividends and through other ordinary commercial transactions between the two countries. He informed the House that after making allowance for all the sterling area's receipts of Canadian dollars of a current nature—such as the proceeds of exports, interest and dividend receipts and Canadian governmental expenditures in sterling incurred in connection with the maintenance of our troops in the United Kingdom—the sterling area's net deficit of Canadian dollars from the outbreak of war until the end of February, 1942, amounted to approximately one billion, seven hundred and seventy million dollars. He stated further that since December, 1940, the date of the last gold shipment from the United Kingdom, the whole deficiency had been financed by Canada and that practically the whole financing task had naturally fallen on the Dominion government. Amongst other ways of easing the situation for the United Kingdom, such as the repatriation of Dominion government and Canadian National Railway bonds owned by British investors, it was decided that Canada should make to the United Kingdom an outright gift of foodstuffs, raw materials, planes, tanks, guns, etc., to the value of one billion dollars, to be financed by the public treasury.

In May, 1943, the War Appropriation (United Nations Mutual Aid) Act was enacted, appropriating a further sum of one billion dollars to cover the cost of goods to be supplied to the United Kingdom and other members of the United Nations during the current fiscal year. The result of these arrangements is that it is understood by all concerned that we in Canada are not allowing financial considerations to limit or interfere with our war effort either in regard to our own forces or in regard to the goods we are supplying to the United Kingdom and our other allies.

On the other hand, it is neither to the advantage of Canada nor to the advantage of the United Kingdom that the British deficit of Canadian dollars should be unnecessarily increased. Such an unnecessary increase could occur in two ways: First, through the transfer of funds from the

United Kingdom and other parts of the sterling area to Canada for such purposes as the acquisition of new investments in this country; and second, through the retention in Canada of sums currently accruing to the credit of residents of the United Kingdom.

The sterling area exchange authorities have taken steps to ensure that transfers falling within the first category mentioned are brought under strict control. In particular, they do not normally grant permits for the transfer of sterling to Canada when the purpose is to effect a transfer of capital. On the other hand, transfers are permitted for such purposes as payment for exports of goods from Canada, payment for services rendered, interest and dividends on sterling securities owned by residents of Canada, remittance of the proceeds of matured life insurance policies and certain types of benevolent remittances approved on a compassionate basis such as a small portion of legacies, remittances for the support of evacuees, withdrawals of capital held in the sterling area by residents in case of extreme need due to old age, sickness, etc., and others of a similar general type.

As regards the second category of items, routine procedures applied by the United Kingdom Exchange Control ensure that the Canadian dollar proceeds of British exports to Canada are surrendered to the exchange control and thus made available to help finance British purchases in this country. Similarly, British residents owning Canadian securities are required to surrender to the exchange control the Canadian dollars received by way of interest or dividends on such securities. The activities of the Foreign Exchange Control Board referred to in the foreword are designed to ensure that in cases where the British investment in Canada takes the form of direct investment rather than portfolio investment the income on such investment (viz., the profits of the Canadian company) is made available to the United Kingdom Exchange Control in appropriate amounts.

DOMINION TAX PAYMENT SCHEDULE, 1944

Also Showing When Returns and Payments on Account of 1944 Taxes are Due in 1945

(This schedule is for convenience only, and obviously can not include the details, which are contained in the acts and in various regulations; it does not include certain requirements, which are contained in the tax payers.)

PERSONAL

Tax	Assessment Period	Tax Form	Returns Due	Tax Payable
Income tax—Persons at least 75% of whose total	1943 (calendar year)	T1 General	April 15, 1944	

PERSONAL

Tax	Assessment Period	Tax Form	Returns Due	Tax Payable
Income tax—Persons at least 75% of whose total income is from wages or salaries	1943 (calendar year)	T1 General or T1 Special	30 April 1944	30 April 1944, balance due after deductions and payments already made
	1944 (calendar year)	T1 General or T1 Special	30 April 1945	30 April 1945, balance due after deductions and payments already made
Income tax—Other persons except farmers	1943 (calendar year)	T1 General or T1 Special	30 April 1944	30 April 1944, balance due after deductions and payments already made
	1944 (calendar year)	T7B	31 March 1944; 30 June 1944; 30 Sept. 1944; 31 Dec. 1944	31 March 20%; 30 June 25%; 30 Sept. 25%; 31 Dec. 30%
Income tax—Farmers	1943 (calendar year)	T1 General or T1 Special	30 April 1945	30 April 1945, balance due after deductions and payments already made
	1944 (calendar year)	T1 General or T1 Special	30 April 1944	30 April 1944, balance due after deductions and payments already made
	1944 (calendar year)	.....	31 Dec. 1944	31 Dec. 1944, 2/3 of tax
		T1 General or T1 Special	30 April 1945	30 April 1945, balance due after deductions and payments already made
Excess profits tax	Fiscal year ended with- in calendar year 1943	EPT7B	31 March 1944; 30 June 1944	31 March 1944, 1/2 balance due; 30 June 1944, balance
		EPT1	30 April 1944	.....
	Fiscal year ending within calendar year 1944	EPT7B	30 Sept. 1944; 31 Dec. 1944; 31 March 1945; 30 June 1945	30 Sept. 1944 25%; 31 Dec. 1944 25%; 31 March 1945, 1/2 balance; 30 June 1945, balance
		EPT1	30 April 1945

CORPORATION

Tax	Assessment Period	Tax Form	Returns Due	Tax Payable
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Excess profits tax	T1 Special	after deductions and payments already made
Fiscal year ended within calendar year 1943	EPT7B	31 March 1944; 30 June 1944, balance due; 30 June 1944, balance
	EPT1	30 April 1944
Fiscal year ending within calendar year 1944	EPT7B	30 Sept. 1944; 31 Dec. 1944; 31 March 1945; 31 March 1945; 30 June 1945
	EPT1	30 April 1945

CORPORATION

Tax	Assessment Period	Tax Form	Returns Due	Tax Payable
Income and excess profits tax	Fiscal year ended within calendar year 1943	T7B Corporations	Seventh month after start of fiscal year (estimate)	By 12 monthly instalments starting in 7th month of fiscal year; 11 of such instalments on estimated basis; balance in 12th instalment
		T2	Six months after close of fiscal year.	By instalments, as above
		T2 Questionnaire	Six months after close of fiscal year	.....
	Fiscal year ending within calendar year 1944	T7B Corporations	Seventh month after start of fiscal year (estimate)	By 12 monthly instalments, starting in 7th month of fiscal year; 11 of such instalments on estimated basis; balance in 12th instalment
		T2	Six months after close of fiscal year	By instalments, as above
		T2 Questionnaire	Six months after close of fiscal year	.....

EMPLOYERS, DEBTORS, FIDUCIARIES ETC.

Covering	Frequency	To be filed by	Form	Due date
Taxes deducted at source				
From salaries and wages	Each payroll period	Employers	TD2	One week after payday
From dividends	Each dividend date	Companies	TD2	One week after date of payment
From registered interest payments	Each payment date	Debtors	TD2	One week after date of payment
From estate income paid to non-residents	Each payment date	Trustees, executors etc.	603	At time of payment
From rentals paid to non-residents	Weekly	Debtors	700	Week following payment
From royalties paid to non-residents	Each payment	Debtors	RR701	15th of month next following deduction
From payments (for casual services) to non-residents	Completion of such services	Employers	WT1	On completion of services
From other taxable payments to non-residents	.....	Payers	603	One week after payment
Information returns 1943				
Income of estates and trusts	Yearly	Trustees, executors etc.	T3	28 February 1944
Salaries and wages paid	Yearly	Employers (including all companies)	T4	28 February 1944
Dividends paid	Yearly	All companies	T5	28 February 1944
Interest paid	Yearly	Debtors (including all companies)	609	28 February 1944
Income payments to addressees in United States	Yearly	Payers	UST 4-5-6	28 February 1944



The Balance Sheet Audit and the Profit and Loss Account

By John A. MacDonald

Montreal, P.Q.

IN the *Royal Mail Steam Packet Company* case His Lordship in summing up was very decisive, "..... the (auditor's) report on the accounts would certainly include a very careful investigation of the profit and loss account as one of the accounts, even if it is not expressly covered in the certificate which is generally accepted as a complete report."

Here is no distinction between large and small companies. Nor is there an auditor's pardon because he has not written his name on what is called a profit and loss statement presented to the shareholders by the directors in company with the balance sheet which the auditor does sign. (And nine times out of ten this profit and loss statement is presented on stationery bearing the imprint of the auditor's name.)

Source of Profits

Prior to the *Royal Mail Steam Packet* case the auditor was concerned merely with ascertaining that the balance in the profit and loss account was a surplus available for distribution regardless of the source from which that surplus was built up. But as a result of this case the auditor has been compelled to take the view that the profit and loss account must show the earnings for the period under review separate from any other credits.

To what extent then may an auditor be justified in omitting to test the profit and loss account to be presented to the shareholders, and does a balance sheet audit comply with the requirements of a statutory audit under the Dominion Companies Act? Or, what is the minimum examination of the profit and loss account required in a statutory audit?

Also, the auditor's responsibility for dividends declared which are distributed out of profits makes it imperative that he be assured those profits are not overstated. Although dividends would not invariably have to be paid out of operating profits, nor out of the profits earned in the period under review, the wording of the Canadian Act is

more stringent on this matter than is the British Act. Consequently when interpreting the British court cases on the legality of dividends, Canadian auditors would be prudent to bear this difference in mind. The British Act does not provide as to the exact manner in which the profits of a company are to be ascertained. But the Canadian Act states definitely that "no account shall be taken of any increase in the surplus or reserve of the company resulting merely from the writing up of the value of the assets." In the British case of the *Ammonia Soda Company, Limited, versus Chamberlain and others*, the writing up of assets was one means at least of substantiating the payment of a dividend, and was upheld by the Court.

Dividends

This comparison of the British and Canadian acts places a great importance on the current position of the Canadian company when deciding whether or not a dividend may be paid. The Canadian Act forbids a dividend which "will impair the capital of the company." The British Act refers to "the shareholders' capital" as that which must not be paid out. The British cases distinguish between "not providing for losses on the fixed capital", and, paying out, more or less directly, these fixed assets or "shareholders' capital" in the form of dividends. The latter is forbidden and the former generally permitted. The wording of the Canadian Act would make this neat distinction difficult.

Thus, the Canadian auditor need go to greater pains than his British fellow to assess the profits for a financial period, if he would avoid negligence in the determination of profits available for dividends.

"An audit of a balance sheet involves the verification of the profit and loss account as the balance of that account must be included in some form or other in the form."—F. R. M. de Paula.

Current Items

One may consider that if the current asset and current liability items on the balance sheet are verified there is very little need of verifying the profit and loss items which are their opposite or contra entries. Because if the position of the current accounts at balance sheet date are verified as correct, then it is assumed the entries in those

accounts have been correct during the period under review. And if the trial balance of the ledger is actually in balance then the opposite entries in the profit and loss accounts must also have been correct.

But, to what extent is the auditor entitled to assume that "the entries in those accounts have been correct during the period under review" simply because the position at the balance sheet date, for instance, of cash or accounts receivable is verified as correct?

Receipts from Sales

This verification at balance sheet date does not prove that sales invoices have not been omitted from the sales recapitulation, and the charge likewise omitted from the accounts receivable. And it does not prove that the cash received subsequently for these goods has not been misappropriated. And on the liability side the verification of accounts payable (if such is in fact possible at all) does not prove that invoices have not been paid fraudulently, nor duplicate invoices paid in error—both perhaps the result of a poor system of internal check.

But, as de Paula pointed out, an audit of a balance sheet involves a verification of the profit and loss account. The problem then is—what constitutes a verification of the profit and loss account?

It must be apparent that a verification of current assets and liabilities—such as is possible in the best of circumstances—is not complete without a verification of the profit and loss account. And there is no absolute method of verification of current items on a balance sheet, as there is for the fixed assets and liabilities. For instance, there may be cash belonging to the business which was never entered in the client's books of account and certainly never deposited in the bank. The same is true of merchandise inventories. The auditor who would simply agree the cash balance as shown by his client's ledger with the bank's verification is like the Hindu legend of the blind men examining the elephant.

Internal Checks

When doing a test or even a detail audit the auditor decides how much testing, or how much detail, of the current transactions he need carry out after studying the system of internal check in his client's office. If the internal check

is good the work of the client's staff is considered to be self-proving. If the internal check is poor or non-existent, or a system is set up but does not function, the work of the staff is not self-proving. Then the auditor must undertake to check their work in regard to the handling of sales, purchases, cash and stocks of merchandise.

But if it is found that this internal check meets all the requirements of proving that the books of current accounts are true records of all transactions, or is a proof of such equivalent to any test which the auditor himself would have carried out, then the auditor is entitled to rely on it for the purpose of verifying the profit and loss account.

It remains necessary for the auditor to make periodic tests of the efficiency of the internal check. The tests necessary to make this appraisal are not the same as the tests carried out while doing a test audit. The motives are different although the necessary functions overlap. The test audit is a test of the weak points in an internal check system. The former is a method of discovering weak points in the system.

Only when a test of the internal check reveals no weaknesses of a nature serious enough to require a test of the current transactions at those weak points may a balance sheet audit be carried out.

Errors of Principle

One strong argument in favour of the balance sheet audit is that errors of principle affect the financial position as shown by the balance sheet to a far greater extent than clerical errors committed which will probably be very small. While doing detail audits there is greater chance of an auditor overlooking errors of principle while finding only some clerical errors, than if he were performing a balance sheet audit.

Only among the very largest clients will an auditor find a system of accounting so efficient as to be virtually self-proving and obviate the need of a test or detail audit. And between them and the smallest private corporation are all degrees of internal check system. In the small corporation except for what tests the owner himself may be able to carry out it is non-existent as one person may be carrying out all accounting duties. A detail audit would be necessary in this case. Between the detail audit and

the balance sheet audit are all degrees of test audits, as the circumstances dictate and the wishes of the client modify.

A Check on Cash

While verifying current assets and liabilities in a balance sheet audit, I would propose that a proper verification of cash consist of testing cash credits in accounts receivable to the cash receipts book. This is not to be considered as a verification of the profit and loss account although it serves in addition as a test of the efficiency of the internal check system. A further minimum requirement for a balance sheet audit would be perpetual inventory records. Likewise the verification of inventories should consist of testing purchase invoices to these stock records, and testing shipments out to sales invoices and accounts receivable, or to manufacturing accounts. The balances on these permanent inventory stock cards are a partial verification of the inventory figure on the balance sheet. It must be supported by a physical inventory taken at the balance sheet date. Again this test of stock records is at the same time a test of the internal check system.

The auditor should also have the privilege of circularizing accounts receivable if he wishes to do so. Circularizing accounts receivable is a part of standard procedure established by the Securities and Exchange Commission in the United States. There the auditor is not bound invariably to this procedure, but if he omits it he must report such omission.

And although it is not a general practice in this country it would appear practical to circularize at least larger trade accounts payable for verification. Loans payable are usually verified.

These are the principle current assets and liabilities and those which will give the auditor the most concern. Thus, testing of current transactions serves primarily the motive, not of verifying the profit and loss account, but of verifying the current assets and liabilities, and only secondly is a verification of the profit and loss account.

The fixed and capital accounts are handled by the auditor in much the same manner whether doing a detail, test, or balance sheet audit.

There may appear to be some ambiguity as to the dis-

tion between a test of the internal check system and a test of current transactions. These may appear to be the same function, or, at least to overlap in their practical application. They do overlap, but the motive is different. In the test of the internal check system the extent of each test carried out is less but the variety of tests will be greater at each audit period.

Auditor's Reports

It is interesting to note that United States auditors must report on serious laxities discovered in the carrying out of the standard procedure of the client's accounting department. This will be revealed in the auditor's report by his reference to verification of the profit and loss account, the short form of report reading as follows:

"We have examined the balance sheet of the XYZ Company as of (date), and the statements of income and surplus for the fiscal year then ended, have reviewed the system of internal control and the accounting procedures of the company and, without making a detailed audit of the transactions, have examined or tested accounting records of the company and other supporting evidence, by methods and to the extent we deemed appropriate. Our examination was made in accordance with generally accepted auditing standards applicable in the circumstances and included all procedures which we considered necessary.

"In our opinion the accompanying balance sheet and related statements of income and surplus present fairly the position of the XYZ Company at (date), and the results of its operations for the fiscal year, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year."

In modification of the form of this short report where laxities in the system of internal control may be found, a release to the members of the American Institute of Accountants dated October 1939 reads as follows: ". in some cases it may be necessary to modify or omit reference to reliance upon the system of internal control."

The Dominion Companies Act asks the auditor to report on the accounts examined by him. Does every auditor who performs what he terms a "balance sheet audit" without testing the operating accounts or the client's accounting system which creates those operating accounts, report such omission to the shareholders? The auditor who quips

that the Act does not ask him to report on the accounts which he has not examined is not keeping the spirit of the law.

Profit and Loss Detail

To satisfy the requirements of the Dominion Companies Act the profit and loss account may be presented to the shareholders in very abbreviated form. Sales and cost of sales need not be shown, nor ordinary items of income and expenditure. Legal expenses, directors' fees, executive salaries, interest on indebtedness not maturing within one year, income from investments, reserves for income taxes, and amounts estimated for depreciation are exceptions. Other than the income taxes these exceptions are not invariably set out in the profit and loss account. All companies are proud, or anxious, to show the amount of income taxes they are paying—much prouder often than of their legal and directors' fees and emoluments. And finally the net profit or loss for the financial period must be shown—and this must not include credits or charges of previous or future financial periods. This point was emphasized in the *Royal Mail Steam Packet Co.* case.

There is a trend in the direction of greater detail being shown in the published profit and loss statement, and of greater significance on the profit and loss account. The increase of income tax problems in the auditor's duties places greater significance on the profit and loss account. The investor attaches greater importance to the profit and loss statement than the balance sheet as "the true value of the assets of a business . . . is dependent upon their capacity to earn profits."

The term "balance sheet audit" is an unfortunate adoption and has led auditors to perform audits of which it is difficult to see how the minimum requirements of the Dominion Companies Act have been satisfied. The form of the profit and loss statement should be as much a matter of concern to the auditor as is the form of the balance sheet in order to "exhibit a true and correct view of the state of the company's affairs," even though the auditor is not required to place his signature thereon.

The auditor who has completed his duties in a proper manner should be as willing to place his signature on the profit and loss statement, at least in a summarized form, as he is to place his signature on the balance sheet.

The Inflation Trend in Britain

By Bryan Pontifex, F.C.A. (England)

THOSE who take more than a combatant interest in the world war are here perturbed about the perils of inflation (I bought in New York in 1923 two million German marks for a nickel). One of the pointers in this direction is the huge amount of the note issue. All notes are now issued by the Bank of England and the total amount issued is included in the statement posted on the door of the Bank of England every Thursday. The total note issue is now £950 millions, equivalent to about £27 per head of the population—men, women and children—in the United Kingdom. The cause of this vastly increased amount over that of prewar is, of course, primarily and fundamentally the larger wages now paid to millions of munition workers, many of whom before the war were unaccustomed to handling relatively large amounts and having no idea of dealing properly with these increased monies, keep them in their trouser pockets. Although this is true of some it is reassuring to know that it is by no means applicable to all, as the figures of the so-called "small savings" (national savings certificates and defence bonds bought and savings banks increased balances) aggregated £2,228,000. Although these figures are eminently satisfactory it behooves us in this country to remember it has all got to be repaid and until it is the country will have to foot an interest bill in respect of these and other borrowings.

Speaking of inflation, it should be known that one of the steps the government has taken to combat it is by subsidies to stabilize the cost of food, etc., at a total cost of £180 millions per annum.

The national debt, which at the end of the great war was some £7,000 millions, will probably be about three times that amount at the end of the world war—it is already £17,700 millions. Expenditure is now £15 millions a day and we can only afford to defray 46% of this out of revenue (taxes and the like) although the United Kingdom raised by taxation last year nearly £2,500 millions—this included £300 millions taxes to be refunded under "post-war credits" a sort of government promissory note.

It is interesting to note how the United Kingdom national debt grew: Before the revolution of 1688, when Wil-

liam of Orange ousted the Stuarts, the national debt was only about half-a-million sterling. The revolution added £16 millions, the Marlborough campaigns £38 millions, the American wars £121 millions, and the Napoleonic wars (when according to the great William Pitt "England saved herself by her exertions and Europe by her example") cost over £600 millions. By 1914 the debt was £650 millions; ten times that amount was added during the terrible three and one quarter years of the great war.

One naturally makes comparisons with the state of the national finances in the fourth year of the last war. Then the income tax rate was 6/-, and the super-tax went up to 4/6, together 10/6 in the pound. Now the income tax rate is 10/- and the surtax goes up to 9/6, together 19/6 in the pound. The present chancellor is therefore able to pay more of the cost of the war out of revenue than the chancellor of twenty-five years ago. Then he borrowed at 5%, now at about 2½%. Then the floating debt was around £1,000 millions, now around £4,000 millions.

Mention has been made of the issue of bank notes. These are now, as stated, wholly Bank of England 10/-, £1, and £5. There are no notes of over £5, and there is no issue at all by the government. It is curious in this connection to notice that in the old country a £5 note is still not legal tender for amounts under £5 and the ludicrous practice of asking the tendered to endorse the note in pencil still obtains—ludicrous because had the tenderer of the note come by it in an irregular manner he would naturally not hesitate to endorse a fictitious name thereon.

Current Accounting Literature

A Summary Prepared by J. D. Campbell

Chartered Accountant

BULLETINS

Cost Accounting

Bulletin No. 5, Volume XXV, 1st November 1943, published by the National Association of Cost Accountants (385 Madison Avenue, New York), carries an article of current interest covering the general topic of wartime costs for which wartime production is responsible, but for which

expenditures will not be made until after the war—"Post-war Reserves."

Post-war Reserves—Victor H. Stempf in an article "Post-war Reserves vs. Subsidies" attempts to remove the misconception that the allowance of charges for the creation of post-war reserves for tax and renegotiation purposes represents the equivalent to granting a concession rather than representing an allowance for true costs which should properly be offset against the income of the war period in presenting an accurate picture of the operating results for these periods. "The whole question is one of the equitable allowance of deductions for costs accruing in the war years, presently disallowed, and as a result of which contractors and taxpayers are assessed on fictional earnings exceeding the amount which should be considered taxable net income or subject to renegotiation."

In discussing possible causes underlying the divergence of opinion as to the nature of the reserves, special reference is made to the legalistic premise of costs incurred. "The tax laws adhere to the legalistic, but unrealistic premise of costs 'incurred' as opposed to the generally recognized accounting principle of 'accrual'."

The statement of policy by the governmental departments underlying the disallowance of provisions for the reserves is set out as (1) the necessity for the reconversion may never arise (2) the nature, extent, and cost of reconversion is too conjectural to warrant present determination (3) the unknown duration of the war precludes an estimate with any degree of accuracy.

Throughout the article special stress is placed on the fact that the reserves requested do not represent a subsidy, a gift or a dispensation, but rather charges of reconversion which are inherently part of the cost of operation during the war years and which should be matched against the revenues of those same years.

A short discussion is presented of the provisions which exist for meeting possible post-war industrial problems in the form of post-war refunds of excess profits tax and carry-back provisions indicating the extent to which these provisions fail to meet the problems which are likely to arise.

In conclusion a solution is suggested to the problem "by direct and specific recognition of provisions for post-war

reserves as allowable tax deductions and as appropriate deductions under renegotiations of war contracts."

War Contract Termination—Ross Nichols in an article "Some Legal Aspects of War Contracts Termination" published in Bulletin No. 6 Volume XXV, 15th November 1943, of the National Association of Cost Accountants, presents an outline of the basic legal factors involved in war contract termination as applied to conditions existing in the United States with the aim of providing a suitable legal background for the accountant to be used in the interpretation by him of existing or subsequent legislation covering the field.

Inasmuch as the measure of damages in the case of an ordinary cancellation of a contract is that the "supplier would receive a sum equivalent to the full contract price less the amount which he saved by reason of the fact that there was no further necessity to perform," which amount includes prospective profits, the government has found it necessary to incorporate termination clauses in government contracts in that "just compensation" does not include prospective profits. The termination clauses inserted in the government contracts have as their intent "first, that termination is within the contemplation of the parties when the contract is made; second, a statement of the measures of damages payable to the contractor in the event the government exercises its right of termination, using for this purpose a measure which excludes prospective profits; and third, a rule or guide in the determination of damages."

ARTICLES

Break Even Chart

Lauren F. Brush in an article "Graphic Analysis of Expense" published in the October 1943 issue of *The Accounting Review*, (Tappan Hall, Ann Arbor, Michigan), discusses the preparation and application of the "break even" chart which is described as a recently developed tool which can be used by accountants in meeting future needs of management for "more detailed information about those factors within the sphere of accounting".

The chart is designed primarily to indicate graphically the relationship which will exist, based on the actual facts which are known, as between sales and expenses at different levels of operating capacity. Where the break even

point is determined at 50% of what is considered as "reasonable attainable performance", operations at more than a 50% capacity will result in a margin of profit whereas those below a 50% capacity will result in a margin of loss.

The theory underlying the preparation of the break even chart is that expenses within any business may be divided into the three categories fixed, semi-variable and variable and that a given percentage of attainable performance must be obtained before the revenue from sales will totally offset the fixed plus the variable expenses.

Illustrative charts are presented indicating the procedure followed in the preparation of the chart. Specific attention is devoted to its various limitations, and suggestions are offered as to ways and means of overcoming certain difficulties which might arise in its preparation such as the determination of the amount of the fixed portion of the expenditures particularly where certain of the expenses are of a semi-variable type.

War Reserves

The November 1943 issue of *The Journal of Accountancy* (13 East 41st Street, New York), carries an article "Special Reserves Arising out of the War" which represents a condensation of a report presented by the Research Department of the American Institute of Accountants. The study proper covers an examination of the nature and amount of the special war reserves currently provided by corporations; their relation to income; and methods used in determining amounts.

The procedure followed in the study consisted of an examination of the published annual reports for 1942 of 551 industrial corporations supplemented by enquiries to representative firms of independent public accounts.

Of the 551 published reports examined it was observed that 338 companies had reserves of the type under consideration, of which 255 represented provisions made by charges against income, 21 by charges against earned surplus or transferred from other reserves, and 101 represented cases where reserves existed but no current provision was observed.

Of the many different types of reserves disclosed four appeared to be of special importance (1) reconversion of

plant and facilities, (2) deferred repairs and maintenance, (3) dismissal compensation, (4) inventories.

In covering the methods utilized in determining the amounts of reserves two general bases are considered, namely, (1) those of a general nature applicable to various kinds of reserves and (2) those which are applicable to particular kinds of reserves. Among the various bases used were included amount of net income, current surplus, percentage of sales, post-war refund credit of excess profits tax, unusual sources of income. Special attention is devoted to a study of the bases used in the case of the four types of reserves previously mentioned.

A series of schedules are appended to the article summarizing the factual results of the research department's study of the published reports.

In the closing commentary it is pointed out that although fairly extensive information was obtained as to the character of the contingency against which the reserves were provided, the amounts provided for such reserves and the percentages to income only limited information was obtained as to the methods used in estimating the amounts put into the reserves.

Economics

Ralph H. Blodgett in an article "The Value of Economics for the Accountant" published in the October 1943 issue of *The Accounting Review*, advances the contention that general and advanced theory of economics form an integral and necessary part in the preparation of the accountant for the work which he will be called upon to undertake. Accountants "should benefit by obtaining the broad economic point of view, as well as the somewhat more limited point of view of accountancy, on all matters with which the two fields of study deal in common."

The article in general outlines briefly certain of the points of contact as between the economist and the accountant in an attempt to illustrate in a concrete manner the various broad and specific benefits which will be derived by the accountant from his more intensive contact with the field of economic theory.

Lawyers and Income Tax

Molyneux L. Gordon, K.C., in an article "Lawyers and Income Tax" published in the October 1943 issue of *The*

Canadian Bar Review (Osgoode Hall Law School, Toronto, Ontario), discusses the present significance of the income tax legislation to the legal profession in general. An outline is presented of the methods to be used in the interpretation of the income tax statutes through the use of available income tax case digests.

A short survey of the evolution of income tax applicable to Great Britain and the Dominions is presented. It is forcibly depicted that the first income tax laws were designed primarily to meet a situation which existed at the time they were set up and that the acts have not been altered since that time to conform with the changing conditions. "In order to prepare a proper financial statement for income tax purposes you first have to adopt opinions which were in force one hundred and fifty years ago and then see how they have been modified by cases which have been decided since the act was enforced."

A further statement made serves to explain to some degree the wide variance between taxable and reported income which sometimes exists. "Undoubtedly the science of accountancy has made great strides in the last hundred years and many changes have been made during that period, but the act has remained the same, so that many settled principles of accountancy have to be disregarded in calculating taxable profits, because these principles have been improved and modernized in the past hundred years, and wherever such improvements differ from the provisions of the Act they ought not to be applied."

Special attention is paid to the terms "wholly", "exclusively" and "necessarily" which appear in the Canadian Income Tax Act covering allowable expenses. "The interpretation of these words has caused more litigation than probably any other three words in the English language and formed a steady income for members of the legal profession for nearly one hundred and fifty years and will continue to do so as long as they are retained in the Act."

Accounting Profits

Alfred Bornemann in an article "Accounting Profits: An Institution" published originally in the *Journal of Political Economy* April 1943, (University of Chicago Press), and republished in the October 1943 issue of *The Accounting Review* discusses the manner in which account-

ing profits (a verbal symbol) has developed into an institution, (cluster of social usages), pointing out the significance both present and future arising from this fact.

With the expansion of markets and the corresponding increase in uncertainty, numerical estimates of business profits became a necessity. Accounting developed out of this necessity as a matter of practical expediency summarizing the customary behaviour in calculating profits and thus became over a period of time a body of principles and standards of accounting for profits which are generally accepted.

Although accounting principles and standards have developed from customary and habitual ways of thinking, evidence is available in the current trend of accounting thought to indicate a gradual process of refinement. Special reference is made to the recent stand taken by Paton and Littleton on the question of the necessity of an accurate matching of costs with related revenues in accounting for profits.

"Guided by the body of conventions based on a combination of theoretical and practical considerations, on the basis of which statements of principles are in turn attempted, accounting has become the accepted device for the calculation of profits Accounting profits have become an institutional device which expresses the end of economic activity in modern society."

War Contracts—Accounting Problems

Maurice E. Peloubet in an article "Accounting Problems in War Contracts" published in the November 1943 issue of *The New York Certified Public Accountant* (15 East 41st Street, New York), considers various accounting problems which may arise in each of the various phases of the war contracts—negotiation, completion, termination and renegotiation.

Throughout the article special stress is laid upon the significance of the responsibility which has been placed on the cost and industrial accountant arising from the conditions created by the war. "Cost accounting is no longer merely descriptive and analytical but has become the criterion of the propriety of payments where any deviation from a standard of accuracy, which is at best theoretical and in practice unapproachable, means cash loss or gain to the parties of the contract".

In discussing the new responsibilities which have been placed on accountants it is pointed out that although absolute and final accuracy cannot be achieved in costs this discrepancy can be compensated to a considerable degree by 'consistency'. "This can hardly be overstressed—nothing is more disturbing than inconsistency to any outside reviewer of accounts whether he be a contracting officer, a government auditor or a public accountant."

The accounting requirements under conditions of termination and renegotiation are discussed in particular in which the significance of maintaining accurate and complete accounting records is stressed particularly from the standpoint of a satisfactory and speedy settlement of claims.

The question of post-war reserves is not overlooked. In discussing the nature of possible future legislation covering this question it is suggested that it would be advisable in making provision for this type of reserves that no restrictions should be placed on the primary provision as to its nature or specific purpose in that although the general nature of the reserves is known it is difficult if not impossible to determine an approximation as to exact amounts required.

In a closing discussion of the new demands which are being made on accountants it is pointed out: "Far from disregarding accounting recommendations, management now demands and expects almost the impossible in the way of costs, records, statements and forecasts. Management is interested in these things now because they mean actual money paid or received."

Amortization of War Facilities

George N. Farrand in an article "Accounting for Amortization of War Facilities" published in the November 1943 issue of *The Journal of Accountancy*, presents the results of an inquiry and research into the preferred method of accounting in financial statements for emergency war facilities subject to sixty-month amortization for tax purposes. (U.S.)

With the advent of greatly increased taxes, tax practice has come to have an important influence on corporate accounting procedures. This is particularly noticeable in the case of the amortization provisions allowed for tax pur-

poses covering emergency plant facilities where the question arises "should amortization be reflected on the same basis for both tax and corporate purposes?"

The study made on the above problem included an examination of published statements supplemented by opinions of a representative group of practising accountants.

Although the general presumption existed that emergency plant amortization should be reflected on the same basis for both tax and corporate purposes the circumstances existing in the individual case may be of a type that would require some modification. "Where it appears that the facilities in a given case will be useful to a given organization beyond the period of the war or the five-year amortization period, it may be desirable to amortize the facilities over a longer period in the accounts. Contrariwise, if it appears that the usefulness of the facilities will end prior to the five-year period a higher rate than 20 per cent may be desirable."

The chief conclusion drawn from an examination of the treatment of amortization in financial statements is that, "regardless of the method of treatment, more adequate disclosure is desirable as to both the existence of amortization and its method of determination for income tax and statement purposes."

Assessment of "Factory Profits"

THAT the taxable income of a non-resident, defined in the Manitoba Income Taxation Act as "the net profit or gain arising from the business of such person in Manitoba", does not include factory profits earned outside the province, was the decision of the Manitoba King's Bench in a recent case. The fact that the accounting system provided for charging goods at factory cost to the sales branches had an important bearing on the decision. Further, it was pointed out that the statute gave the minister full discretion as to the method of proportionment, and also to determine the amount of tax. "Within the scope of these sections", said the judgment, "there would seem to be sufficient authority for the minister to arrive at the tax payable once the principle of proportionment is established".

The income concerned was that for the years 1936 to 1939. By agreements made in 1941-42, the provinces have

vacated the income tax field in favour of the Dominion, for the duration of the war.

The case was *re Wm. Wrigley (Jr.) Co. Ltd.* The judgment, delivered March 10th, 1943, by Justice Major, is as follows:

"The Wm. Wrigley (Jr.) Co. Ltd., appeals from a decision of the provincial treasurer of Manitoba in regard to assessment for income tax purposes for the years 1936 to 1939, both inclusive. The province claims the right to tax all the net profits received by the appellant company from sales made by the Manitoba branch of the business. The company disputes this and claims that the only profits that can be taxed are those arising from the business in Manitoba.

"Section 24 (1), c. 209, R.S.M. 1940, being the Income Taxation Act, is as follows: 'The income liable to taxation under this Part of every person residing outside of Manitoba, who is carrying on business in Manitoba, either directly or through or in the name of any other person, shall be the net profit or gain arising from the business of such person in Manitoba.' This section has been in the Manitoba statutes since 1930. There has been no material change to it in subsequent revisions and consolidations, and it is applicable to the taxation years herein involved.

"It is necessary to outline the company's methods of operation.—The company is incorporated under the Dominion Companies Act and is licensed to do business in Manitoba. Its head office is in Ontario and its product, which is chewing gum, is manufactured in that Province. This product is sold in Manitoba and other parts of Canada. The business is administered from its head office. The company has branch premises in Manitoba, consisting of an office and warehouse in which stocks of merchandise are stored for distribution to its customers. This merchandise is shipped from the place of manufacture in Ontario to Manitoba in carload lots, in order to take advantage of the lower freight rates on carload shipments to Winnipeg. A manager who is in charge of the Winnipeg branch requisitions from time to time such merchandise as may be necessary and supervises the detail men, or salesmen, who, among other duties, make sales to jobbers in accordance with the sales policy laid down by the head office of the company. As part of this selling policy the company prepares and

supplies to the Winnipeg branch a list of approved customers and prescribes the maximum credit to be allowed each such customer. Within these limits salesmen can and do make sales to the named customers; but neither the manager nor any salesman has authority to sell to any person if that person's name does not appear on the list. When a sale is made the merchandise is shipped to the customer from the stock in the Winnipeg warehouse. Invoices for such purchases are prepared in the Winnipeg office in triplicate,—one copy of which is given to the customer, one sent to the head office, and the third is held at the Winnipeg office. Thereafter the Winnipeg office has nothing further to do in regard to the accounts—payment for such merchandise being made direct to the head office in Ontario.

"Since the incorporation of the company it has set up in its books a manufacturing division and a selling division. There has been no separate incorporation of these divisions. On transferring the merchandise from the manufacturing section to the selling section the latter is charged on the books of the company with a set factory price for the merchandise. This price is determined by adding a factory profit to the costs of production. There is no question of a sale by the manufacturing division (Ontario) to the selling division (Manitoba); the shipment invoice merely defines the merchandise forwarded. The selling division then sells to the jobber at a price fixed by the company, and the jobber in turn sells to the retailer at a price also fixed by the company. To determine the net profits of the selling division the company credits it with the amount received from its sales to jobbers and charges it with the factory price of merchandise, as well as a proportion of the administration expense.

"In the accounts presented to the Court, the company has shown the gross returns from its sales through the Winnipeg office and has deducted therefrom an item designated as 'cost of sales'—the balance resulting being termed 'gross profit'. In the item 'cost of sales' there is included an amount shown as 'factory profit'. The Province claims that the amount charged in the item 'cost of sales' as 'factory profit' is not a disbursement or expense laid out or expended for the purpose of earning the income; that it cannot be deducted as part of the cost of sales and therefore

is taxable as income arising from business of the taxpayer in Manitoba.

"Section 6 of the Act provides as follows: '1. In computing the amount of the profits or gains to be assessed, a deduction shall not be allowed in respect of (a) disbursements or expenses not wholly, exclusively and necessarily laid out or expended for the purpose of earning the income.'

"The Province further claims that no profit can be obtained until a sale is actually made, and that as the sales were made from the Winnipeg branch of the company the profits therefrom are profits arising from the business of the company in Manitoba.

"The appellant company takes the position that factory profits are properly deductible; that they are not profits arising from the company's operations in the Province, and that the Province has by its legislation recognized the principle of proportioning profits and the company was justified in charging its Sales Division with factory profits. This is the only point which was seriously submitted and argued by the appellant's counsel. This argument may be summarized as follows:

"It is not the profits received in Manitoba that are taxable—it is the profits arising from the business in Manitoba. It is not the profits arising from the company's manufacturing business in Ontario and from the company's operations in Manitoba taken together—but the proceeds arising from the company's operations in Manitoba. The whole point accordingly turns upon interpretation of the words in s. 24: 'arising from the business of such person in Manitoba.'

"A similar question, among others, was involved in the case of *International Harvester Co. v. Provincial Tax Commission*, reported in [1941], 3 D.L.R. 65, S.C.R. 325. While the judgment of the majority of the Court did not deal specifically with that particular point, (the appeal being disposed of on other grounds), it was dealt with by Duff C.J.C. at p. 67 D.L.R., p. 330 S.C.R., and as the language of the statute there under consideration is for our purpose identical with the Manitoba statute, the opinions there expressed appear to me to dispose of the question.

"Section 21(a) of the Saskatchewan Act is identical with the words of s. 24 of the Manitoba Act, with the excep-

tion of the words 'Part' and 'Manitoba'. The provision of s. 3 of the Saskatchewan Act which defines 'income' is in the same words as are contained in s. 3 of the Manitoba Act; and likewise, the above quoted s. 6(1) (a) of the Manitoba Act is identical in words with s. 6 of the Saskatchewan Act.

"It was urged by the Province that as the majority of the Supreme Court upheld the assessments which had been made by the Taxing Commissioner, and as these assessments did not take into consideration any question of, or make any allowance for, a manufacturing profit—the right of the Province of Saskatchewan to tax a manufacturing profit, if such existed, was affirmed.

"I cannot accept this reasoning. As I read the judgment of the majority of the Court, it does not go so far as to establish the right of the Province to tax manufacturing profits arising outside Saskatchewan. All it does is to declare the validity of the regulations. The appellant in the Saskatchewan case was not able, by reason of its book-keeping system, to show the profit and loss accounts for its business in Saskatchewan and elsewhere, and therefore the method provided by the regulations and applied by the Commissioner was the best available means to ascertain the income. It is to be noted that the method provided by the regulations was not applicable where the method or system of accounting enabled the Commissioner to obtain the information required to ascertain the income of the taxpayer. In the present case, the appellant's accounting system appears to contain all the information necessary to determine the income arising from the business of the company in the various Provinces in which such business is done.

"Reference has also been made by the Province to the dissenting judgment of Kerwin and Hudson JJ. in the case of *Firestone Tire & Rubber Co. v. Com'r of Income Tax*, [1942], 4 D.L.R. 433, at p. 451, S.C.R. 476 at p. 494. Kerwin, J., (adapting the statement of Isaacs J., in *Com'rs of Taxation v. Meeks* (1915), 19 C.L.R. 568 at p. 588) said: ' The manufacture in Ontario of the appellant company's goods, however necessary to the existence of its business, does not earn income. The goods are manufactured for the purpose of sale and the income is earned when the goods are sold and all the income, therefore, was earned within the Province of British Columbia . . . ' This, it is

urged, is a rejection of the theory of a manufacturing profit. This judgment, however, was careful to point out that the entire scope of the British Columbia Act imposed a tax upon 'the income earned within the province' of a non-resident taxpayer, and is quite different from the Saskatchewan statute which imposes a tax upon the 'net profit or gain arising from the business of such person in Saskatchewan.'

"Reference to s. 23 of the Manitoba Act dealing with inter-company sales and purchases, also s. 26(1) dealing with income tax partly arising from creative operations within the Province, seems to support the view that in certain cases where manufacturing takes place in one Province and selling takes place in another Province there would have to be an allocation of profits as between the manufacturing and selling divisions.

"I have to conclude that the appellant is on sound ground and is entitled to allocate a portion of its profits to the Manufacturing Division in Ontario, and that such portion is not subject to the income tax provisions of the Manitoba statute.

"The method of proportioning the income is one which presents some difficulty. The appellant has submitted several proposals, of which at least two would be acceptable to it for the purpose of arriving at a basis of settlement of its income tax. These however are not acceptable to the Province, and the appellant now urges the Court to decide the method of proportionment. It is to be noted that ss. 26, 27 and 27(a) of the statute, dealing with the taxation of a non-resident doing business within the Province, give the Minister full discretion as to the method of determining such proportionate part of the income. Section 47 also gives power to the Minister to determine the amount of the tax to be paid by any person. Within the scope of these sections there would seem to be sufficient authority for the Minister to arrive at the tax payable once the principle of proportionment is established.

"During the course of the hearing, Mr. Walter J. Macdonald, a chartered accountant of considerable experience, was called by the appellant to give evidence and to present an analysis of the earnings of the company. He also presented a formula which appears to me to provide a reasonable method of proportionment of profit as between the

Manufacturing and Selling Divisions. It is prepared on a pro ration of costs basis, and, in the absence of any other formula, or failure to exercise the powers given to the Minister as above indicated, I direct that it shall be applied in determining the tax payable by the appellant.

"The appeal will be allowed, with costs."

Provincial News

MANITOBA

Mr. John Parton, F.C.A., one of the leading members of The Institute of Chartered Accountants of Manitoba, recently celebrated his 65th birthday, and his fellow members take this opportunity of publicly offering him their felicitations.

Mr. Parton was born in England on November 22, 1878, and came to Canada in 1907. In 1911 he became a partner in the firm of Messrs. Webb, Read & Hegan, and on the amalgamation of that firm with Messrs. George A. Touche & Company in 1919 he became a partner of the latter firm.

Mr. Parton has been a member of the Manitoba Institute since 1909, and has served for thirty years on the Council. In 1932 he was awarded a Fellowship in recognition of his services. He has served as president of the Manitoba Institute and of The Dominion Association of Chartered Accountants. He is, and has been for some time, chairman of the Dominion Association Committee on Terminology.

It is the prayer of Mr. Parton's fellow members and many friends that he will long be spared to use his gifts for the benefit of the members of his profession and of the public at large.

"YOUR INCOME TAX"

A 1944 edition of "Your Income Tax" by A. R. McMichael, B.A., F.C.A., has been published by The Musson Book Company Ltd., Toronto, at \$1 per copy. It follows the general style of Mr. McMichael's earlier editions, that is, the T.1 General and Special forms are reproduced, and are marked so as to refer the reader to the pages of the text in which the explanations of the various items are found. The book is mainly for individuals, and therefore covers the personal income tax, and the excess profits tax in respect to individuals and partnerships, but there is also a short chapter on personal corporations, and a short summary of corporation taxation. Provision is also made for sending to purchasers of the book a report on amendments that may be made before April 1st.

THE QUESTIONNAIRE INVESTIGATOR

(Courtesy of The Montreal Gazette)

Reference: B and B.3c —24614. File Inv. Form A628-M-Q:

As Head of the Division of Provision for Revision

Was a man of prompt decision —Merton Quirk,
Ph.D. in Calisthenics, P.D.Q. in Pathogenics

He had just the proper background for the work.

From the pastoral aroma of Aloma, Oklahoma,

With a pittance of a salary in hand,

His acceptance had been whetted, even aided and abetted

By emolument that netted some five grand.

So, with energy ecstatic, this fanatic left his attic

And hastened on to Washington, D.C.,

Where with verve and vim and vigor, he went hunting for the Nigger

In the woodpile of the W.P.B.

After months of patient process, Merton's spicular proboscis

Had unearthed a reprehensible hiatus,

In reply by Blair and Blair to his thirteenth questionnaire

In connection with their inventory status.

They had written—"Your Directive when effective was defective

"In its ultimate objective, and what's more,

"Neolithic hieroglyphic is to us much more specific

"Than the drivel you keep dumping at our door".

This sacrilege discovered, Merton fainted, but recovered

Sufficiently to write—"We are convinced

"That sabotage is camouflaged behind perverted persiflage—

"Expect me on the 22nd inst."

But first he sent a checker, and then a checker's checker

Still nothing was disclosed as being wrong.

So a checker's checker's checker came to check the checker's checker.

And the process was laborious and long.

RECENT TAX RULINGS

Then followed a process of the Follow-up profession,

Through the records of the firm of Blair and Blair.

From breakfast until supper, some new super-follow-upper

Tore his hair because of Merton's questionnaire.

The file is closed, completed, though our Hero undefeated

Carries on in some Department as before;

But victory is in sight, not because of, but in spite of

Merton's mighty efforts in the War.

RECENT TAX RULINGS

The following are some recent rulings or interpretations in connection with income and excess profits taxes. The first four of these are in part condensed from recent issues of "The Canadian Bar Review"; the Department of National Revenue has not confirmed them as official.

Renegotiation of Munitions Contracts

Where taxes have been paid on munitions contracts which are subsequently renegotiated, appropriate adjustments will be made as follows:

Where the assessment has not issued or is not debarred from being reopened by reason of the provisions of section 56 of the Income War Tax Act, the amount to be refunded will be treated as a charge against the profits in the year in which they were brought into account.

Where the assessment cannot be reopened by reasons of the provisions of the said section 56 of the Act, application will be made to the Governor-in-Council and if the requisite authority is given, a refund of the tax paid on the profits returned will be made.

The taxpayer may authorize that any tax refunded be paid over directly to the Department of Munitions and Supply as a whole or partial repayment of such unreasonable profits.

Refund of Compulsory Savings

A refund of the so-called compulsory savings of deceased persons will be made under the following conditions, when application therefor is supported by satisfactory evidence of the death: (1) That all returns on behalf of the deceased have been filed and all income and excess profits tax liability has been discharged in full; (2) that the estate is being wound up and distributed immediately, and is not being held by the trustees or executors for future distribution. For 1943 and subsequent years the total tax liability of deceased persons, including the refundable portion, will be required to be paid after which an application for a refund may be made and will be subject to the above conditions.

Pension Fund Deductions

In cases where employees serving in the armed forces are entitled to have their pension fund status maintained (under the Civil Employment Act, 1942, chap. 31) the following is allowed:

The employer may continue to pay into a pension fund any obligation required in connection with such employees but not greater than that paid in respect of such employees in the last year of service before entering the armed forces. Further, and for the purpose of calculating the aggregate compensation paid within the calendar year and the deduction permitted under section 5 (1) (f) of the Income War Tax Act, there may be included an amount equal to the salaries paid to

such employees by the employer in the year immediately prior to their entering the armed forces.

The employer may also assume the obligation of the employee to contribute to the pension fund, and if this is done the amount so assumed and paid will be allowed as a deduction to the employer and will be deemed to be income of the employee. This will be reported by the employer in his return of salaries or wages paid, and the employee will then be allowed to deduct it to the extent permissible under section 5 (1) (g) of the Act.

Exemption for Illegitimate Child

The words "blood relationship, marriage or adoption" as contained in paragraph (c) of rule 1, section 1 of the 1st Schedule and in paragraph (c) of rule 3, section 2 of the 1st Schedule of the Income War Tax Act are to be read as including illegitimate children. The effect of the ruling will be to grant the appropriate relief to "an unmarried person" who maintains a self-contained domestic establishment and supports the child therein. It will not apply in respect of such children who may be maintained by the taxpayer but not in a "self-contained domestic establishment" as defined in section 2 (1) (j) of the Act. It must be presumed also that it will not be granted to any married person who may maintain and support a child in such an establishment.

Refunds of Tax Deductions

The Department of National Revenue is now authorized to make refunds of taxes deducted at the source even though the application for such refund is not made by the taxpayer within the twelve month period specified in the Act. This authority was granted by Order in Council 121/8660 passed 10th November 1943, approving a recommendation of the Treasury Board which reads as follows:

"The Board recommend, under the War Measures Act, that authority be granted to the Honourable the Minister of National Revenue to make refunds of amounts withheld under sections 91 and 92 of the Income War Tax Act notwithstanding the provisions of subsections 19 and 8 thereof respectively in cases in which he ascertains the taxpayers to be non-taxable in respect of the amounts so withheld."

PERSONALS

Messrs. Thorne, Mulholland, Howson and McPherson, chartered accountants, announce the admission to partnership of Messrs. J. G. Brown, W. H. Moore and H. E. Crate, all of whom have been associated with the firm for many years.

Mr. Albert Freedman, chartered accountant, announces the removal of his office to 88 Richmond Street West, Suite 308, Toronto 2B. His telephone number now is Adelaide 8575.

STUDENTS' DEPARTMENT

R. G. H. SMAILS, C.A., Editor

NOTES AND COMMENT

Some of our readers may recall that the report on "Extensions of Auditing Procedure" adopted by the American Institute of Accountants at the annual meeting on September 19, 1939, recommended a short form of audit report in which occurs the sentence, "[We] have examined or tested accounting records of the company and other supporting evidence, by methods and to the extent we deemed appropriate".

The original recommendations of the special committee to the annual meeting further required the auditor to "make suitable explanation or exception in reporting on the financial statements of a concern over his signature (a)" if he had "not made, or observed the making of, physical tests by count, weight or measurement, either because such tests in his opinion are not practicable or reasonable, or because he has departed from normal auditing procedure", and (b) if, for any reason, he has not confirmed accounts receivable. These instructions were omitted from the report as finally adopted, on the grounds that negative references of the kind contemplated (where exceptions were not required) "gave rise to misconception" and "had the effect of casting an unwarranted cloud on the statements".

* * *

The Securities and Exchange Commission has gone on record, however, as feeling that the original recommendation of the committee would lead to the more satisfactory results and that "the disclosure required in that earlier version is the minimum that we should accept as complying with our requirements for disclosure of the scope of the audit". The Commission countered the Institute's argument by reasoning that it should be clear from the auditor's language whether the reference is intended as an exception on the one hand or purely as a matter of information or description on the other.

As a prejudiced party we find ourselves aligned with the Institute—on the grounds that to give shareholders information of which they can make no intelligent use is merely

to confuse them. Since the Commission's fiat runs to all corporations whose stocks are listed on the U.S. exchanges or who are offering securities to the public it is not surprising to find the auditor to a Canadian corporation with a very large American shareholding reporting, "it was not practicable to confirm [certain] receivables, but with respect to these we have satisfied ourselves by means of other auditing procedures". Presumably it is implicit in this report that the auditor *had* confirmed the rest of the receivables and *had* made physical tests of inventory in accordance with the "Extensions of Auditing Procedure."

* * *

The last-in-first-out inventory method appears to be making some headway in the United States for we recently encountered published reports of a distillery corporation which had adopted it "subject to review by the United States Treasury", with a resultant eight million dollar drop in reported inventory values. In this country the tax authorities appear to prefer the method of the special inventory reserve as a hedge against subsequent fall in values. The two methods should give roughly similar results.

* * *

STUDENTS' ASSOCIATION NOTES

QUEBEC

Lectures on Income Tax

There was an attendance of over six hundred at each of the three lectures on Personal Income Tax and Excess Profits Tax, Corporation Income Tax and Excess Profits Tax, given by Arthur W. Gilmour, B.Com., C.A., of the Department of National Revenue, Income Tax Division, Montreal, on November 12th, 19th and 26th. Mr. A. H. Rowland, Inspector of Income Tax, introduced Mr. Gilmour at the first meeting. Our thanks are extended to Mr. Rowland for his co-operation. Mr. Gilmour is to be congratulated on the excellence of his lectures; he seems to have the faculty of not only making a dry subject interesting, but also amusing at times, and the members were loud in their praise of the manner in which the series was conducted. There are still a number of copies of the booklet prepared by Mr. Gilmour entitled "Notes on the Dominion of Canada Income War Tax Act, The Excess Profits Tax

Act and The Wartime Salaries Order" available at fifty cents each, plus five cents for postage.

Mock Trial of Auditors

A Dinner and Mock Trial of Auditors was held at the Queen's Hotel on Friday evening, the 17th December, with an attendance of nearly two hundred. Reg. Dawson was in the chair. The cast included: Judge, Chief Justice Marma-duke Cholmondesley "Butch" Peabody—Alex. Ballantyne; plaintiff, Ebenezer Ramsbottom (a decent fellow, nevertheless)—John Newland; defendant, Y. Egbert (we don't know) Snoopnagel, the Auditor—Phil Pugsley; counsel for plaintiff, Elmer Framem and Ichabod Doolittle of the firm of Framem and Doolittle—John MacDonald, Gordon Hutchison; counsel for the defence, U. Catchem and I. Rookem of the firm of Catchem and Rookem—Emory Grearson, Charlie Knowles; directors, Joshua Hokus, president—Bert Bishop; Jeremiah Pokus, secretary-treasurer—Van Harris; D. Sokus, director—Stan Wickes; clerk of the court, Christopher Otis Prune—Maurice Brain.

Notwithstanding the humour introduced by several members of the cast, some good educational points for students were brought out in the cross-examination by counsel, and particularly in the summing up by the judge, who pronounced the defendant "guilty of negligence", with costs, but no damages were awarded to the plaintiff. Phil Pugsley's performance as the auditor was outstanding, and Emory Grearson's cross-examination of the witnesses was masterly. Maurice Brain did a good job as clerk of the court. Considering that no rehearsal was held beforehand, the cast did very well. F/O Vic. Houghton, just back from overseas was given a rousing "welcome home", and it was regretted that Sgt. David Lloyd Hart, M.M., who crossed on the same boat as Vic, was unable to be present, as he was leaving for Brockville to take an officer's training course. Dave was decorated by His Majesty the King in recognition of his bravery and coolness under fire and devotion to duty in the Dieppe raid. We hope to see you later, Dave.

Students Overseas

Cigarettes have been sent to ninety-one students serving in His Majesty's Forces overseas, also a letter of Good Cheer and Best Wishes assuring them that plans to help

them with their studies when they return, are being made. Each student was also sent the names and addresses of the ninety-one overseas, so that they may communicate with each other. To date the Quebec Students' Society has two hundred and thirty-eight students in the armed forces out of a total of five hundred and twenty-five.

Presentation of Brief

Next there will be two lectures on the preparation and presentation of briefs before the Board of Referees re standard profit claims by E. C. Leetham, C.A., to be followed by a Mock Presentation of a Brief before the Board of Referees. These should be particularly interesting to chartered accountant members of the Students' Society.

Lectures for French-Speaking Students

A successful series of lectures for the French-speaking students was conducted by Mr. Andre Leroux, C.A., Mr. C. Rene Dufresne, C.A., and Mr. Gerald Labelle of the Department of National Revenue, during the months of October and November.

* * * *

CORRESPONDENCE

Edmonton, Alberta.

Dear Sir:

Thanks to your very helpful suggestion, I have discovered, to my mind, a very satisfactory method of tackling this type of question (Preparation of Manufacturing, Trading, Profit and Loss, and Surplus Accounts and Balance Sheet).

I shall proceed to explain to you my method which is almost identical with your suggestion. First of all I take one sheet of foolscap and reserve it as a record of adjusted accounts. I then make all adjustments from information given and instead of allocating plus and minus amounts to my various accounts as in unadjusted trial balance, I merely place a vouch mark beside the old balance and carry that balance to my adjustments sheet. Then I add or subtract as required and underline the adjusted balance.

Then as I go down columns of adjusted trial balance I pick up the true balance by the ticks referring to the adjustments sheet. In this way I have come upon an almost foolproof system.

STUDENTS' DEPARTMENT

To date I have attempted a great many questions of this type. Every single time I have hit a true balance on the balance sheet.

You of course understand that this method is purely an examination technique. I am very strongly advised by my principal that working papers are requisite in the ordinary run of audit procedure. Speed, however, is essential in most accounting exams and accuracy of calculations combined with a thorough knowledge of classifications under Manufacturing, Trading, and Profit and Loss Accounts and the Balance Sheet is in my opinion, the essence of this type of problem.

Sincerely yours,

(Signed) A. S. KNOWLER.

PROBLEMS AND SOLUTIONS

THE PROVINCIAL INSTITUTES OF CHARTERED ACCOUNTANTS

Solutions presented in this section are prepared by practising members of the several provincial Institutes and represent the personal views and opinions of those members. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM I

INTERMEDIATE EXAMINATION, DECEMBER 1942

Accounting II, Question 4 (25 marks)

At 31st December 1938 the capital of Smith and Jones, a partnership, was as follows:

	Capital	Profit ratio
Smith	\$48,000	60%
Jones	30,000	40%

On 1st January 1939 Smith sold one-third of his partnership interest at that date to Wilson for \$20,000.

The partners were to receive yearly salaries as follows:

Smith	\$8,000
Jones	5,000
Wilson	4,000

Smith was also entitled to receive yearly a bonus of 10% of the net profits, after treating as an expense the partners' salaries and the bonus.

The operating results for the three years subsequent to the admission of Wilson were:

1939—Profit after charging partners' salaries and bonus to Smith	\$10,000
1940—Loss after charging partner's salaries	16,000
1941—Profit after charging partners' salaries but before charging Smith's bonus	2,200

During the period the partners' drawings were:

THE CANADIAN CHARTERED ACCOUNTANT

	Smith	Jones	Wilson
1939	\$10,000	\$6,000	\$5,000
1940	8,500	6,400	5,500
1941	10,000	8,000	6,000

The partnership was dissolved on 31st December 1941 and the assets were realized with the following results:

	Book Value	Realized	Loss
January 1942	\$ 65,000	\$55,000	\$10,000
February 1942	25,000	18,000	7,000
March 1942	20,000	10,000	10,000
	<u>\$110,000</u>	<u>\$83,000</u>	<u>\$27,000</u>

All of the firm's creditors were paid in January 1942, and cash distributions to the partners were made at the end of January and February with a final payment at the end of March. (The costs of liquidation may be disregarded.)

Required:

Prepare a columnar statement of the partners' capital accounts from 1st January 1939 to the final liquidation, and schedules showing how you arrived at the distribution between the partners of the liquidation payments.

SOLUTION

Columnar Statement of the Partners' Capital Accounts
from 1st January 1939 to Final Liquidation

1939					
	<i>1st January</i>				
	Item	Smith	Jones	Wilson	Total
	Balances before admission of Wilson	\$48,000	\$30,000		\$78,000
	Transfer of one-third of Smith's interest to Wilson	16,000		\$16,000	
	Balances after transfer	32,000	30,000	16,000	78,000
	<i>31st December</i>				
	Salaries for year	8,000	5,000	4,000	17,000
	Bonus to Smith, 10% of \$10,000	1,000			1,000
	Profits for 1939	4,000	4,000	2,000	10,000
		<u>45,000</u>	<u>39,000</u>	<u>22,000</u>	<u>106,000</u>
	Deduct—				
	Drawings for year	10,000	6,000	5,000	21,000
	Balances at end of year	35,000	33,000	17,000	85,000
1940					
	<i>31st December</i>				
	Salaries for year	8,000	5,000	4,000	17,000
		<u>43,000</u>	<u>38,000</u>	<u>21,000</u>	<u>102,000</u>
	Deduct—				
	Loss for year	6,400	6,400	3,200	16,000
	Drawings for year	8,500	6,400	5,500	20,400
	Balances at end of year	28,100	25,200	12,300	65,600

STUDENTS' DEPARTMENT

1941

31st December

Salaries for year	8,000	5,000	4,000	17,000
Bonus to Smith, 1/11 of \$2,200 ..	200			200
Profits for year	800	800	400	2,000
	<u>37,100</u>	<u>31,000</u>	<u>16,700</u>	<u>84,800</u>
Deduct—				
Drawings for year	10,000	8,000	6,000	24,000
Balances at end of year	27,100	23,000	10,700	60,800

1942

31st January

Loss on realization	4,000	4,000	2,000	10,000
	<u>23,100</u>	<u>19,000</u>	<u>8,700</u>	<u>50,800</u>
Cash distribution	4,950	850		5,800
	<u>18,150</u>	<u>18,150</u>	<u>8,700</u>	<u>45,000</u>

28th February

Loss on realization	2,800	2,800	1,400	7,000
	<u>15,350</u>	<u>15,350</u>	<u>7,300</u>	<u>38,000</u>
Cash distribution	7,350	7,350	3,300	18,000
	<u>8,000</u>	<u>8,000</u>	<u>4,000</u>	<u>20,000</u>

31st March

Loss on realization	4,000	4,000	2,000	10,000
	<u>4,000</u>	<u>4,000</u>	<u>2,000</u>	<u>10,000</u>
Final cash distribution	4,000	4,000	2,000	10,000

Calculation to determine payment to creditors at 31st January

Cash available for distribution to partners at 31st January 1942

Cash realized on sale of assets during January	\$55,000
Less paid to creditors	49,200
Cash available for distribution	<u>\$ 5,800</u>

The amount owing to creditors is arrived at as follows:

Total book value of assets on	
31st December 1941	\$110,000
Total partnership capital on	
31st December 1941	60,800

Difference representing amount due to creditors .. \$ 49,200

Calculation to determine distribution to partners of cash available at 31st January

	Smith	Jones	Wilson	Total
Profit and loss ratio	40	40	20	100
Capital balances after distributing				
loss on assets realized	\$23,100	\$19,000	\$8,700	\$50,800
Maximum loss on remaining assets ..	18,000	18,000	9,000	45,000
	<u>5,100</u>	<u>1,000</u>	<u>(300)</u>	<u>5,800</u>

THE CANADIAN CHARTERED ACCOUNTANT

White's capital deficiency distributed*				
Smith 40/80	150			
Jones 40/80		150		
Distribution of cash	\$ 4,950	\$ 850	..	\$ 5,800

*On the assumption that the ruling in *Garner v. Murray* is not applicable.

Calculation to determine distribution to partners of cash available at 28th February

Capital balances after distributing loss on assets realized	\$15,350	\$15,350	\$7,300	\$38,000
Maximum loss on remaining assets ..	8,000	8,000	4,000	20,000
Distribution of cash	\$ 7,350	\$ 7,350	\$3,300	\$18,000

The partners' capital balances are now in the profit sharing ratio and any subsequent distribution of cash will be made in that ratio. The loss on dissolution, \$27,000, is borne: Smith, \$10,800; Jones, \$10,800; Wilson, \$5,400.

PROBLEM II

FINAL EXAMINATION, DECEMBER 1942

Accounting IV, Question 1 (15 marks)

Smith, Jones and Robinson are the members of a partnership. The partnership agreement provides that the partners shall be credited with annual salaries of: Smith \$8,000, Jones \$6,000, Robinson \$5,000; that interest shall be allowed at 5% on the average balances of the partners' accounts during the year; and that the balance of profit shall be divided as follows: Smith 50%, Jones 30%, Robinson 20%.

For the fiscal year ended 30th June 1942 the average balances in the capital accounts, and the balances at the end of the year, before crediting salary allowances, interest, or profit, are as follows:

	Average balances	End of year balances
Smith	Cr. \$75,000	Cr. \$62,000
Jones	Cr. 14,000	Cr. 11,000
Robinson	Cr. 16,000	Cr. 17,000

The profit for the year ended 30th June 1942, before any of the above adjustments or excess profits tax, was \$44,000. The "standard profit" is \$32,000, and the partnership is claiming the maximum salary allowance for each partner.

The partners wish to have their capital in the profit sharing ratios, and have agreed to distribute amounts of cash so that this will be brought about. No partner is to pay in any money, but it is desired to distribute the lowest possible amount of cash.

Required:

Prepare a statement of the partners' accounts, showing balances at 30th June 1942 before closing, allocation of the net profit, the cash distributed and the closing balances.

SOLUTION

Item	Smith	Jones	Robinson	Total
Profit or loss ratio	50	30	20	100
Balance, 30th June 1942	\$62,000	\$11,000	\$17,000	\$90,000

STUDENTS' DEPARTMENT

Interest on average balance at 5% per annum	3,750	700	800	5,250
Salary	8,000	6,000	5,000	19,000
Balance of profit (See calculation below)	5,375	3,225	2,150	10,750
	<u>79,125</u>	<u>20,925</u>	<u>24,950</u>	<u>125,000</u>
Cash	44,250		11,000	55,250
	<u>\$34,875</u>	<u>\$20,925</u>	<u>\$13,950</u>	<u>\$69,750</u>

Estimate of excess profits tax

Profit for year	\$44,000
Less: Salary allowances	15,000
	<u>29,000</u>
15% of \$29,000:	\$4,350

Profit as above	29,000
Standard	32,000
Less: Salaries	15,000
	<u>17,000</u>
75%	12,000
	<u>\$9,000</u>

Calculation of balance of profit

Profit	\$44,000
Less: Tax	9,000
	<u>35,000</u>
Salaries	19,000
	<u>16,000</u>
Interest	5,250
Balance	<u>\$10,750</u>

BOOKLET CORRECTIONS

The Society of Chartered Accountants of the Province of Quebec advises us of the following corrections in the booklet entitled "Notes on the Dominion of Canada Income War Tax Act, The Excess Profits Tax Act and the Wartime Salaries Order" by A. W. Gilmour, which was mentioned in THE CANADIAN CHARTERED ACCOUNTANT in December.

Page 17: Line 23—\$68.79 should read \$6,879.

Page 50: Paragraphs 4 and 5—Paragraphs commencing "Here again the new rates" and "Therefore in the illustration" should be deleted. The 15% tax applied to the calendar year 1941 and fiscal periods ending therein. Accordingly if the 1941 fiscal year ended on April 30, 1941, the 15% tax would apply to the profits for the full year.

Page 57: Line 5—\$630 should read \$6,300.

Page 64: Line 1—"Tax of 12%" should read "Tax of 15%" and on Lines 1 and 9 \$1,759 should read \$2,199.

Page 106: Lines 4 and 5—\$487 should read \$263 (\$750—\$487).

Page 121: Line 3—The words "remaining three years" should read "four years."

Page 128: Line 31—The words "add to the income" should read "deduct from the income."

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